

Antitrust Practice Group

HOWREY CLIENT ALERT

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RYANAIR/CHARLEROI DECISION— WHEN ARE INCENTIVES GRANTED TO AIRLINES BY REGIONAL AIRPORTS LAWFUL?

- State-owned airports may not offer incentives to airlines wishing to operate new routes unless those incentives meet strict criteria.
- On 3 February 2004, the European Commission ruled that a number of financial and commercial advantages granted to Ryanair by Belgian authorities for the use of Charleroi airport breached EC State aid rules and must be reimbursed.
- Incentives will only be accepted by the Commission if they are necessary to the opening of new routes and granted in a transparent and non-discriminatory manner.
- Their duration must be limited (five years for direct flights), they must not represent more than 50% of the costs incurred to start the new route and should be available to any airline established at the airport in question.
- The Commission's decision will have profound implications for the European air transport sector, and the Commission can be expected to issue policy guidelines that strike a balance between the wish to enforce State aid rules and the aim of fostering the development of low-cost air travel in Europe.
- Many current commercial arrangements between regional public airports and airlines will have to be reassessed.

I. INTRODUCTION

On 3 February 2004, the European Commission (“the Commission”) at last issued its long-delayed decision on the lawfulness, under EC State aid rules, of a number of financial and commercial advantages granted to the “low-cost” air carrier Ryanair related to the use of

Charleroi airport, one of the airway's main European bases.

According to the Commission, some of the measures taken in favour of Ryanair, the airport's main user, by the Walloon Region (Belgium) and by the airport's management body, Brussels South

Charleroi Airport (“BSCA”)¹, constitute illegal State aid and must therefore be reimbursed.

The ruling’s importance for the future of air transport in Europe cannot be over-emphasized: as Ryanair’s angry reaction suggests, the assessment carried out by the Commission’s Directorate-General Energy and Transport may represent a blow to the core of the business model underlying the operations of many “low-cost” operators across Europe, namely the operation of services to/from cheaper secondary public airports.

In effect, such airports, which are often State-owned, tend to offer extremely advantageous conditions to attract the extra traffic generated by the arrival of “low-cost” operators such as Ryanair.

From a legal perspective, in the absence of clear guidelines setting out the types of incentive schemes compatible with State aid rules, the Commission’s decision does not dispel the legal uncertainty that air carriers which have struck similar deals with State-owned airports currently face.

II. BACKGROUND

The Commission’s investigation was triggered by a complaint, lodged in January 2002, alleging that illegal non-notified State aid had been granted to Ryanair and to BSCA.

Broadly, a State aid can be defined as any economic advantage granted by a Member State of the EU that is likely to distort competition. According to Article 88 EC Treaty, all State aid must be notified and authorised to the European Commission before it is granted. If the aid is not notified, it will be deemed illegal, but the Commission may still declare it compatible with the internal market if it conforms to certain policy goals in this

¹ BSCA is a public undertaking controlled by the Walloon region.

area. To that effect, the Commission will open a formal investigation procedure and publish a notice identifying the aid in question and calling for submissions by interested third-parties.

The aid in question stemmed from the terms of two agreements concluded by Ryanair with the Walloon region and BSCA respectively. The Commission informed the Belgian authorities of its doubts as to the legality of the aid, and after prolonged discussion of the case published a notice setting out its preliminary findings and inviting interested third parties to submit their comments².

The measures which the Commission deemed to represent State aid incompatible with the proper functioning of the internal market included:

- a) Advantages granted by the Walloon Region, such as reduced landing fees, to the exclusive benefit of Ryanair;
- b) Concessions granted by BSCA relating to the costs of recruitment, training and subsistence of Ryanair staff, ground-handling prices, the opening of new routes and the provision of office space; and
- c) In addition, BSCA agreed to make a substantial contribution to Ryanair’s promotion and advertising costs. In return for the advantages granted by BSCA, Ryanair has assumed certain obligations over a period of several years, which could safeguard the airport’s revenues.

III. DECISION

To the extent that some of the advantages granted to Ryanair were found to be compatible with the common market, the Commission decision of 3 February 2004

² Notice published pursuant to Article 88(2) EC in OJ 2003/C18/03.

does not go as far as the case notice opening the examination procedure might have suggested.

In its decision, the Commission distinguishes between:

- a) Advantages granted to Ryanair by the Walloon government. These included a preferential rate for landing charges at Charleroi of EUR 1 per boarding passenger, representing around 50% of the standard rate set in a decree published in the Official journal of the Kingdom of Belgium; and
- b) Advantages granted by BSCA, namely:
 - a contribution towards promotional activities of EUR 4 per boarding passenger, over 15 years and up to 26 daily flights, paid to Promocoy, a company jointly owned by Ryanair and BSCA;
 - one-off incentives designed to facilitate Ryanair's launch at Charleroi: EUR 250,000 for hotel and subsistence expenses of Ryanair personnel, payable on proof of purchase by production of invoices in successive payments of EUR 20,000 per month; EUR 160,000 per new route opened, to a maximum of 3 routes per plane, i.e. a maximum amount of EUR 1,920,000 (max 4 planes based at the airport); and EUR 768,000 for participation for recruitment, crew and pilot training expenses allocated to the new destinations served by the airport; EUR 4,000 for purchase of office equipment, making available 100 square meters free of charge; 100 square meters for an "engineering store"; access rights to "training room"; and a minimum or nil charge for the use of an aircraft maintenance hangar;
 - a reduced rate of EUR 1 per passenger for ground-handling services, i.e. approximately 10 times lower than the average rate charged

to other airlines of between EUR 8 and EUR 13.

STATE AID

In order to determine whether these measures constituted aid, the Commission applied the Market Economy Investor Principle ("MEIP"), according to which the test of whether a measure can be qualified as an aid is whether the recipient undertaking "receives an economic advantage which it would not have obtained under normal market conditions". This test is used to determine whether a benefit or advantage has been conferred in circumstances in which the State has acted as a participant in the market. In such cases, the question is whether the advantage is one that would or could have been obtained from a private operator acting with a view to obtaining a commercial return.

In the case at hand, the Commission took the view that the terms of the agreements concluded by BSCA with Ryanair did not conform to the MEIP, as no private operator in the same circumstances would have granted Ryanair such advantageous conditions, and thus constituted State aid.

In particular, the Commission noted that at the time the contract was concluded, BSCA "was exposed to the risk of losses exceeding the company's aggregate current result over a ten-year period, which is estimated to be about EUR 35 million, and this would have wiped out any hope of a fair return on the investment over the reference period"³.

Furthermore, the Commission held that BSCA's business plan, which underpinned the commercial agreement with Ryanair, took into account uncertain sources of revenue not flowing from the contact itself but stemming from the use of Charleroi airport by other hypothetical airlines.

³ See Commission Press Release IP/04/157 of 3 February 2004.

Finally, the Commission claimed that the profit forecast for the whole operation was also based on certain economic assumptions which no private undertaking would be able to take into account. In effect, according to the Commission, BSCA took advantage of its special connections with the Walloon region in order to factor into its business plan a subsidy to cover maintenance costs and fire, for which there was no legal basis at the time the contract with Ryanair was concluded. Similarly, BSCA also signed the contract at a time when the legal instrument setting out the proportion of aviation charges, due by the airport, to be allocated to an environment fund and had not been adopted. The Commission reasoned that a private operator not possessing ties with the State would not have concluded such a contract amidst so much uncertainty as to future regulatory developments.

With regard to the advantages conferred by the Walloon region, the Commission found that the reduction in landing charges constituted an act of a regulatory nature which did not warrant application of the MEIP test. The Walloon region was deemed to be acting in its capacity of a State/Regional authority, as opposed to acting as an undertaking operating in the market as a private party, and therefore the measure would definitely constitute aid.

ILLEGAL AID

Once it had established that the financial measures in favour of Ryanair constituted State aid, the Commission went on to examine whether they could be deemed compatible with Community law.

Having noted that the aid in question represented operational aid, usually not authorised, the Commission nevertheless concluded that certain advantages granted to Ryanair might be admitted in the context of the Community's transport

policy in accordance with Article 87(3)(c) of the Treaty.

These consisted of those aids that would foster the development of underused State-owned airports, contributing to attract new customers and generate revenue for infrastructures which hitherto represented a financial burden to the community as a whole.

As such, the Commission decided that BSCA's financial participation in marketing and promoting Ryanair's flights, as well as some of the one-off incentives, could be deemed aid to the start-up of new routes and would not need to be recovered.

In the part of the decision with the most far-reaching consequences, the Commission set out the specific criteria which have to be observed by national authorities if such advantages are to be authorised under Article 87(3)(c) of the Treaty:

- They must be necessary to the opening of new routes and granted in a transparent (i.e. publicised) and non-discriminatory manner.
- Their duration must be limited (five years for direct flights), they must not represent more than 50% of the costs incurred to start the new route and should be available to any airline established at the airport in question.

The Commission rejected every other advantage granted by BSCA or the Walloon region and ordered their recovery. With regard to the reduced airport charges, the Commission asserted that, according to its own previous decisional practice, only non-discriminatory and transparent reductions would be authorised, even if their aim were to provide an incentive to the commencement of new services.

In respect of the reduced ground handling fees, the Commission held that the charges actually levied on Ryanair did not cover the cost of providing the service. They represented a discriminatory measure and could not be offset by revenue flowing from other tasks carried out by BSCA in its role of airport authority.

Lastly, all other one-off incentives for the opening of new routes, such as contributions towards hotel and subsistence expenses of Ryanair personnel, expenses for the recruitment and training of crews and pilots and to the purchase of office equipment were deemed not to be sufficiently tied to the goal of promoting the airport's development to be authorised.

The gist of the Commission's case against the incentives awarded to Ryanair was thus the lack of transparency surrounding the whole process and the preferential treatment given to the airline by public entities.

IV. CONSEQUENCES

The Commission's decision will have profound implications for the European air transport sector. Although it does not depart from prior Commission decisions⁴, it represents the first case in which the delicate issue of commercial arrangements negotiated by a "low-cost" carrier was ruled upon.

The number of State-owned airports vying against each other and offering advantageous conditions to "low-cost" operators such as Ryanair in order to lure them has increased steadily. It will therefore be necessary for these airports to devise incentives that conform to the criteria outlined by the Commission, particularly with respect to the obligations

⁴ Such as Case NN/109/98 UK, in which discounts on landing fees granted by Manchester airport were at stake.

to ensure transparency and non-discrimination.

By contrast, privately owned airports are not subject to State aid rules, and could therefore negotiate freely with airlines, thereby putting their State-owned competitors at a disadvantage. The only case in which a private airports' ability to discriminate between airlines would be restrained is if it is deemed to hold a dominant position in its catchment area.

The Ryanair/Charleroi case is also likely to lead to an increase in the number of actions before national courts challenging similar concessions granted to other airlines. In this respect, a precedent had already been set by a ruling from a Strasbourg court⁵ finding that certain benefits received by Ryanair for the operation of flights from that city's airport constituted illegal State aid insofar as they did not represent adequate consideration for the promotion of the region.

However, the Commission's decision in the present case alone will not solve the intricate problems raised by these commercial practices. If the framework within which regional airports and airlines may cooperate is to be made sufficiently clear and legal certainty enhanced, the Commission will have to issue policy guidelines that strike an adequate balance between the desire to enforce State aid rules and the avowed aim of fostering the development of low-cost air travel in Europe. The Commission's ongoing investigation of a similar case involving alleged aid awarded by the French State-owned airport of Pau to Ryanair is also likely to provide further guidance.

With regard to the decision's effects on airlines' pricing policies, the Commission seems particularly sensitive to the negative reactions that can be expected from

⁵ Tribunal Administratif de Strasbourg, Décision du 24 juillet 2003, Affaire n° 01-04641.

consumers should airfares increase. It remains to be seen whether the Ryanair/Charleroi case will, as the Commission stated, foster competition between low-cost carriers “to the maximum benefit of consumers”.

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