COMMISSION

COMMISSION DECISION

of 21 December 1993

concerning aid to be provided by the Irish Government to the Aer Lingus group, an undertaking mainly providing air transport services

(Only the English text is authentic)

(Text with EEA relevance)

(94/118/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having given notice in accordance with the above Article to interested parties to submit their comments and having regard to those comments,

Whereas :

I

By letter of 12 August 1993 registered with the Commission's Secretariat-General on 2 September 1993, the Irish authorities, upon a written request from the Commission, notified the Commission, in accordance with Article 93 (3) of the Treaty, of their intention to inject £ Irl 175 million equity into the Aer Lingus group (hereinafter 'Aer Lingus') over a period of three years.

The proposed equity injection forms part of a restructuring plan called 'Strategy for the Future' (hereinafter 'the plan'), which the Irish authorities enclosed with the notification. The plan was approved by the Irish authorities on 6 July 1993 and the Irish Minister for Finance, as shareholder, was authorized to inject £ Irl 175 million equity into Aer Lingus. This injection is to be carried out as follows : £ Irl 75 million in 1993, £ Irl 50 million in 1994 and £ Irl 50 million in 1995.

The timing and amount of the equity injection are subject to the following conditions :

(a) the conclusion of an agreement with the appropriate Irish unions on an essential £ Irl 50 million annual reduction in Aer Lingus' costs ;

(b) production of satisfactory evidence that the proposed measures are being implemented in full ;

(c) formal acceptance by the Commission of the strategic plan and the proposed equity injection.

The purpose of the equity injection is to reduce Aer Lingus' burden of debt and help to restore its interest cover and debt equity ratios to prudent levels within an applicable period.

In the notification the Irish authorities expressly recognized that the proposed equity injection in Aer Lingus is an aid pursuant to Article 92 of the Treaty. However, they maintained that the aid might be considered compatible with the common market pursuant to both Article 92 (3) (a) as regional aid and Article 92 (3) (c) as aid to facilitate the development of certain activities.

On 13 October 1993 the Commission decided to initiate the procedure pursuant to Article 93 (2) of the Treaty with regard to the planned £ Irl 175 million equity injection in favour of Aer Lingus. In view of the severe negative financial position of Aer Lingus at the time of the notification, the Commission decided, under the market economy investor principle, that the provision of capital contained aid elements pursuant to Article 92 (1). Moreover, the aid character of the equity injection was not contested by the Irish Government. The main reasons for initiating the procedure were the Commission's doubts on several aspects of the restructuring plan and its effects on competition. In particular, the Commission needed to be assured that :

— the cost reductions, which involve a number of measures including negotiated redundancies, are realized as envisaged in the plan,

— the payment of the second and third tranches of the aid are subject to the company achieving specific targets, in particular with regard to productivity improvements,

— the aid is the last for the period in question,

— the objectives pursued by the new policy adopted by Aer Lingus at Shannon Airport do not prejudice the viability of the plan,

— the aid is not used to transfer Aer Lingus' difficulties to its competitors and, particularly, does not have unacceptable adverse competitive effects on certain routes where traffic level is very high and competition is intense, such as the London-Dublin route,

— the aid does not have the effect of strengthening Aer Lingus' position to an extent contrary to the common interest in ground handling activities at Irish airports,

— the corporate restructuring of the company into four divisions is subject to the stamp and capital duties which apply to similar corporate operations in Ireland.

By letter of 20 October 1993 the Commission informed the Irish Government of its decision and gave it due notice to submit its comments. This letter was published in the Official Journal [1], and pursuant to Article 93 (2) of the Treaty, the other Member States and interested parties were also invited to submit their comments.

II

The Irish authorities presented their comments within the procedure by letters of 24 November and 9 and 13 December 1993, by fax of 8 December 1993 and during several meetings held with the relevant officials of Directorate-General VII of the Commission in Dublin and Brussels. The Irish authorities did not contest the legal and economic analysis which led the Commission to qualify the equity injection as aid pursuant to Article 92 (1) and open the Article 93 (2) procedure. The Irish authorities addressed all the issues that the Commission raised in the opening of the procedure and which required further clarification. In particular:

1. with regard to the reduction in costs, the Irish Government confirmed to the Commission that 'it will not make the equity injection unless it is satisfied that the £ Irl 50 million annual reduction in costs in Aer Lingus is being implemented in full ... and will require independent verification that the £ Irl 50 million annual reduction in costs in Aer Lingus is being implemented in full.' Moreover, the Irish Government informed the Commission that 'the cost cutting programme has been negotiated and agreed between the company and the relevant unions' and that 'the way is now clear for Aer Lingus to successfully implement the necessary £ Irl 50 million cost cutting programme ...';

2. with regard to the linkage between the payment of the second and third tranches of the aid and the achievement of some more specified targets, the Irish Government undertook that it 'will report to the Commission on the progress of the restructuring programme, on the financial and economic development of the Aer Lingus group and its companies, and on the achievement of the commitments' made in previous correspondence with the Commission with regard to productivity improvements. Moreover, the Irish Government undertook that 'the report will be given at least four weeks before the payments of the second and third tranches of the aid in 1994 and 1995 in order to give the Commission the possibility to comment if necessary';

3. with regard to the final character of the aid, the Irish Government assured the Commission that the present aid to Aer Lingus 'is the last one for the period of the restructuring' and clarified its 'intention not to grant any further aid to Aer Lingus in the future';

4. according to the Irish Government the new strategy envisaged for Shannon Airport reflects the commercial and financial considerations of the airline. The strategy would have been freely chosen by Aer Lingus among several 'options ranging from the status quo (leading to eventual closure) to full integration with a United States carrier'. The corresponding forecast financial results have been based on very conservative assumptions. In the light of the latest information on the traffic trend on the routes between Ireland and the USA, the Irish Government is confident that the new strategy will produce strong financial results. As regards Boston, the Irish Government assured the Commission that 'it has not imposed any obligation on Aer Lingus to fly the Shannon-Boston route during the non-tourist season.' Moreover the Irish Government stated that 'Boston is a niche market for Aer Lingus and winter cancellation would have a negative impact on summer performance, particularly in the context of business traffic and cargo';

5. as regards the effects of the aid on Community trade, the Irish Government maintains that 'they are not interfering and will not interfere with the commercial management of the airline'. The Irish Government states that the equity injection will not be used to subsidize loss-making routes. As a follow-up to the restructuring, the Government will require the airline to operate on each major route group in a commercially viable fashion. Moreover, the plan will not be over-

[1] OJ No C 291, 28. 10. 1993, p. 4.

expansive and will not enable Aer Lingus to increase its Community market share at its competitors' expense. Aer Lingus will not expand its existing operating fleet (1) over the restructuring period, other than for the transatlantic routes where additional aircraft may be required for the peak summer season to maintain capacity levels, in the event that the 747-100 aircraft currently operated is replaced by a smaller aircraft. Aer Lingus does not intend to change the general pattern of its operations over the restructuring period. Furthermore, it does not have market share objectives and its operations will be based solely on profit motives.

The Irish Government confirmed that the money received will be used entirely to meet the restructuring costs and reduce the debts of Aer Lingus in order to restore the company's financial position. Moreover, the Irish Government stated that 'Aer Lingus will not, for the duration of the programme buy shareholdings in any other Community airline.'

The Irish authorities state that under the proposed restructuring of the group the new divisions, including Aer Lingus Express, if and when established, 'will become and operate as separate legal entities'. To ensure transparency the accounts of these companies will be separately audited.

Regarding Aer Lingus Express the Irish Government informed the Commission that the establishment of this low-cost operation has not, for the time being, been decided. The Government gave the assurance that the operation of Aer Lingus Express 'will only be put in place when the airline can demonstrate in full detail (i.e. on both costs and revenues) that such a low cost operation can operate profitably in an already very competitive low cost market.' Moreover, if created before the end of the restructuring period Aer Lingus Express will operate within the framework of Aer Lingus' existing operating fleet.

The Irish Government states, with regard to the traffic situation on the Dublin-London route that data on load factors show that this route is not affected by overcapacity and that '... it could be argued that the fact that two extra carriers are planning to start services on the route and that sea carriers have increased passenger numbers by 8 % in 1993 on 1992, shows that there is a shortage of air capacity.'

However, the Irish Government gave assurances concerning capacity not to be exceeded in 1994 and 1995. In this respect the Irish Government stated that 'for the calendar year 1994 ... the number of seats offered for sale to the public on Aer Lingus scheduled services will not be more than 3,42 million for Ireland/United Kingdom routes and 1,43 million on the Dublin/Heathrow route.' These figures reflect Aer Lingus' capacity in the 12 months prior to notification of the aid. The Irish Government informed the Commission that by agreement between the Commission and Ireland, independent assessors will be appointed by mid-1994 to review actual and prospective performance for 1994. Should the growth of the United Kingdom/Ireland market so warrant, the capacity figures mentioned above would be adjusted to reflect such growth. At the same time, an independent assessment of actual and prospective market growth will be carried out for 1995 so as to permit Aer Lingus additional capacity in line with any increase in the total market;

6. regarding exclusive rights for ground handling at Irish airports, the Irish Government stated that 'it is inaccurate to say that Aer Lingus has exclusive rights at the Irish airports'. Every airline is allowed to self handle at Irish airports and the percentage of third party traffic which is handled by Aer Lingus is very low;

7. as regards duties, the Irish Government gave the Commission the assurance that, 'under Irish legislative provisions, neither stamp duty nor capital duty will be payable on the proposed restructuring and equity injection.'

III

The United Kingdom Government, a number of Aer Lingus's competitors on the United Kingdom/Ireland routes, in particular Ryanair and British Midland, and other interested parties commented on the case. In general all these parties supported the Commission's decision to open the Article 93 (2) procedure and raised a number of issues which are partly linked to the doubts expressed by the Commission's decision. The third parties' common concerns were mainly related to the fact that the aid to Aer Lingus may affect trading conditions to an extent contrary to the common interest. These concerns may be summarized as follows:

(1) The fleet operating scheduled services consists of three B747-100, six B737-400, ten B737-500, six Fokker 50, four SAAB-340B; in addition the company may use two B767 for peak services only, as well as four freighters (one B737, three DC8).

— the restructuring of Aer Lingus, and particularly the establishment of Aer Lingus Express, may maintain or create overcapacity on certain United Kingdom-Ireland routes. The equity injection would enable Aer Lingus to maintain on these routes the same level of capacity or increase the present capacity at uneconomic fares. Aer Lingus might with the help of the aid operate new routes or re-enter routes previously abandoned. The creation of overcapacity would harm the competitors' position by reducing their load-factors, obliging them to offer uneconomically low fares or forcing them out of business (1),

— the possibility for Aer Lingus to use the aid to set its fares at a level below its costs. This price practice on a Community route would be carried out in order to compete with carriers which are more efficient or which offer a cheaper service on that route,

— the possible lack of transparency of the financial relations between the companies belonging to the Aer Lingus group. Some of the interested parties maintain that as a consequence of the restructuring Aer Lingus will set up a low-cost carrier (Aer Lingus Express) which will not operate independently but will be cross-subsidized. The introduction of low-cost operations on routes which are cost driven could harm the competitive position of the competitors and in certain cases could even force them out of business,

— the possibility for Aer Lingus to use the aid to buy additional shareholdings in Community airlines,

— minor concerns related to Aer Lingus' privileged position at Irish airports and the fiscal treatment of the corporate restructuring.

Moreover, Aer Lingus' union (CRC) also intervened within the procedure arguing that no aid was involved and that in any case the State intervention could be authorized pursuant to Article 92 (3) (a) and (c) without conditions.

(1) It is worth noting that another competitor submitted a complaint to the Commission on 19 April 1993, alleging that Aer Lingus has infringed Article 86 of the Treaty by engaging in predatory pricing on the London Heathrow-Dublin route, which the Commission is at present investigating.

All these comments were transmitted to the Irish Government, which replied to the above arguments within the procedure.

IV

The Aer Lingus group currently comprises two companies, Aer Lingus plc and Aerlinte Eireann plc. These two companies share common ownership, a common management and board of directors, and their accounts are combined.

Besides air transport services, the major activities pursued by the group are :

(a) airline services (maintenance, ground handling and other ancillary services to aviation). The main subsidiary is TEAM Aer Lingus (hereinafter 'TEAM') which employs some 2 000 people and is engaged in aircraft services, component overhaul and engineering support services ;

(b) hotels. Aer Lingus own and manages, under the Copthorne brand name, a number of hotels situated in the major cities of the United Kingdom and some European cities such as Paris and Brussels ;

(c) commercial holdings. Aer Lingus manages a portfolio of companies engaged in computer services, personnel service industries, and a minority share holding in GPA, the aircraft lease company.

Air transport is the core and by far the most important activity of the group. Aer Lingus is one of the smallest of the former 'flag-carriers' of the Community. It operates 29 airplanes for scheduled passenger services. The group employs about 12 700 people, 5 000 of which are in the airline sector, the group's turnover was £ Irl 817 million in the financial year 1992/93 (£ Irl 522 million for the airline).

Aer Lingus is the main provider of services within, to and from Ireland. The main routes operated by Aer Lingus are in order of importance : Ireland-London (this is the largest network. In 1992/93 the passengers carried by all the airlines were 2 980 000 of which 61 % was carried by Aer Lingus. However, Aer Lingus' market share on the London-Dublin routes has declined sharply to 46 % in the April/September 1993 period), Ireland-Continental Europe, Ireland-United Kingdom provincial destinations, and the transatlantic routes (New York and Boston are the only two destinations). The routes flown are predominantly short-haul, even the north Atlantic ones are the

shortest flown by any Community carrier. Accordingly, the airline's fleet is mainly composed of B737 planes, which were acquired at the end of the 1980s and the beginning of the 1990s, and make up an extremely young short-haul fleet indeed. On the contrary, the fleet for the transatlantic routes consists of three Boeing 747-100 aircraft dating from 1970/71, which it is intended to replace before 1995/96. Overall, Aer Lingus has, with an average age of 5,3 years, one of the youngest fleets in Europe.

Aer Lingus, after nine years of profitability, has been making losses since 1991/92. For the financial year 1991/92 the group posted a pre-tax loss of £ Irl 3,1 million and a £ Irl 11,8 million net loss. In the financial year 1992/93 the net loss increased to £ Irl 188 million. Such a negative result is mainly due to the por operating results, restructuring costs and the entire write-off of shares in GPA, due to the collapse of its flotation a year ago (1). The collapse of the value of GPA shares contributed £ Irl 44 million to the 1992/93 losses and impacted negatively on Aer Lingus' reserves by a further £ Irl 69,6 million. Apart from GPA the negative result is also due to the poor performances of the other divisions. The services division profit before exceptional items and tax plummeted from some £ Irl 14 million in 1991/92 to £ Irl 6 million one year later. In 1992/93 TEAM made a loss, before tax, of £ Irl 2,5 million following a profit of over £ Irl 3 million in the previous year.

Aer Lingus' main problems are however caused by the airline division which has been loss-making since 1989/90 posting pre-tax losses of £ Irl 42 million in 1990/91, £ Irl 38 million in 1991/92, and £ Irl 50 million in 1992/93 (in addition to £ Irl 60 million for exceptional items, including restructuring costs and the write-off of the GPA participation). Comparisons with other European airlines show that the Irish carrier appears in a worse position than some major competitors.

Aer Lingus has been affected by the downturn in the sector as have some other airlines, as well as by the major structural changes arising from liberalization.

This situation is not expected to improve in the near future. The forecast loss before tax and exceptional items, if restructuring measures are not promptly undertaken, is £ Irl 58 million in 1993/94 (£ Irl 64 million for the air transport division).

The negative impact of the recent results on the financial position of Aer Lingus has been very serious. The shareholders funds (equity) have decreased from £ Irl 361 million in 1991/92 to £ Irl 93 million in 1992/93. The group's net debt has increased from £ Irl 494 million in 1991/92 to £ Irl 539 million in 1992/93. The debt/equity ratio has increased by 378 %, from 1,37 in 1991/92 to 5,18 in 1992/93.

This shows that because of its poor results Aer Lingus is facing a serious financial crisis.

Aer Lingus' problems seem, for a large part, due to external factors, notwithstanding some important internally controllable factors which are discussed below. The most evident external factor lies in the structural character of Aer Lingus's markets which, to a great degree, are dominated by leisure traffic.

Aer Lingus' home market is very small and generally loss making. In fact, the Irish Government intends to impose public service obligations on the major domestic routes to guarantee a sufficient level of air traffic.

Aer Lingus' key market, Ireland-United Kingdom, following an agreement between the Irish and British governments, was significantly liberalized from 1986. The deregulation and the designation by the Irish Government of other Irish carriers led to increased capacity and competition on the Ireland-United Kingdom routes. British Airways withdrew its services on the London/Dublin route in 1991 because of the poor profit perspectives. Aer Lingus has been facing fierce competition from privately owned low-cost carriers (such as British Midland and Ryanair), resulting in lower yields and operating margins. To face such a situation Aer Lingus had reduced, by the end of 1992, its capacity on several of its Community routes. The most significant reduction was a 20 % decrease of the airline's capacity on the Dublin-London route. This was achieved by ending flights between Dublin and Gatwick and reducing the number of flights between Dublin and Heathrow.

(1) It must be noted that despite its negative outcome the investment in GPA made in 1975 has been largely positive. Past sales of GPA shares and dividends paid by GPA to Aer Lingus have brought to Aer Lingus' balance sheet £ Irl 70 million profit over the cost of the original investment.

The airline's position on the north Atlantic market has been seriously harmed by the intensified competition on the United Kingdom-USA routes. The American mega-carriers have introduced new services to and from London, and direct flights to the USA from northern British cities such as Manchester and Glasgow which are closed to Ireland. As a consequence the share of travellers using indirect flights to Ireland increased from 40 to 55 % in 1992. The competitive position of the airline on the north Atlantic has also been weakened by the policy pursued by the Irish Government with regard to Shannon airport which serves the west and the mid-west of Ireland. This policy, which required every transatlantic flight to and from Ireland to touch down at Shannon, has its origins at the time when a stop-over in Shannon was necessary for technical reasons; it has been maintained over almost 50 years to support employment and to contribute to the development of the Irish mid-west region. It has, however, also denied Aer Lingus the possibility of operating direct flights from Dublin, where the airline is based. The compulsory Shannon stopover has prevented Aer Lingus from developing Dublin as a hub, caused additional costs, and made Aer Lingus lose traffic on the Dublin-USA routes which has had an important negative impact on the airline's overall results. In fact, Aer Lingus has been losing about £ Irl 10 million per year on transatlantic routes in recent years.

A further cause of the present crisis is the fleet renewal programme which was started, as with many other airlines, on a basis of over-optimistic economic forecasts in the 1980s. There was also a need at that time to replace old aircraft. New planes were delivered starting in late 1987 throughout the crisis till April 1993 and had too be financed through high-interest loans at a moment when the worldwide economy was entering a slump.

Aer Lingus is also suffering from its high-cost structure and relatively poor productivity, which leaves room for substantial improvements. The lack of productivity is particularly problematic if one takes into account that the airline is carrying a high degree of the leisure traffic which puts pressure on its yields. The carrier, therefore, is in a difficult situation where the 'scissor' of low yields and low productivity is cutting into its operating results.

The seasonality of Aer Lingus' business is a further problem.

The Irish authorities enclosed with their notification a plan, which is to be implemented by 1995, for the restructuring of Aer Lingus' financial situation and commercial viability. The plan is mainly aimed at restructuring the core airline business. This objective is to be achieved by:

(a) restructuring the group into four operating divisions:

— Aer Lingus, which will continue to operate the existing routes within Ireland, to the United Kingdom, and to continental Europe,

— Aer Lingus Shannon, based at Shannon airport, which will operate on the transatlantic routes to the USA,

— Aer Lingus Express, which will be a low-cost/low-fare carrier operating mainly on the highly competitive Ireland-United Kingdom market,

— subsidiary and support companies (e.g. TEAM), which will become independent profit centres responsible for their own cost structure;

(b) amending the Shannon stopover policy. Under the new plan the transatlantic fleet is to be entirely based at Shannon. Shannon will continue to be directly linked to New York and Boston (a twice weekly non-stop service to Boston in the winter which increases to six weekly services in the summer with connection to Dublin all year round and a daily non-stop service to New York during the summer period only). In addition a service will be operated all the year from Shannon to Dublin and then non-stop to New York;

(c) reducing the group's cost base by some £ Irl 50 million per year. This target is to be achieved by cutting payroll and overhead expenditures. Of the total saving, an amount of some £ Irl 34 million relates to the payroll (which represent 80 % of Aer Lingus' controllable costs.) For this purpose up to 1 530 redundancies (12 % of the group total workforce) may be necessary (1 280 jobs in the airline sector and 250 at TEAM);

(d) disposal of non-core assets, mainly the Copthorne Hotel chain, which was valued in the 1991/92 annual report at £ Irl 235 million (before taking account of associated debt).

As a consequence of this new strategy Aer Lingus expects to return to profitability in 1994/95, and to reduce its net debt from £ Irl 539 million at 31 March 1993 to £ Irl 102 million at 31 March 1997.

The split-up of the group into four independent divisions should help to increase flexibility as well as transparency regarding profit and loss making.

V

Article 92 of the Treaty provides that 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 is incompatible with the common market in so far as it affects trade between the Member States.

In the present case the Irish authorities have planned to inject £ Irl 175 million equity into the State-owned company Aer Lingus by way of a capital increase, in three tranches.

The Treaty establishes the principle of neutrality with regard to the system of property ownership existing in the Member States and the principle of equality between public and private undertakings (Article 222). As a consequence of these principles the Commission's action cannot prejudice or advantage public entities when they inject capital into undertakings. However, the Commission must investigate financial intervention from public funds into companies to prevent Member States from infringing, through State aid, fair competition within the common market.

The Commission considers that in the case of financial injections from public funds no aid is involved if there are some private minority shareholders who participate in the operation proportionately to their shareholdings. It is essential that the private investors' shareholdings have economic relevance [1]. The present case cannot, however, be examined under this principle because Aer Lingus, with the exception of the directors' qualifying shares, is 100 % owned by the Irish Government.

In determining whether State aid is involved the Commission bases its assessment on the market economy investor principle. According to this principle no State aid is involved when fresh capital is contributed in circumstances that would be acceptable to a private investor operating under normal market economy conditions [2].

The Court of Justice has stated that the conduct of a private investor, with which the intervention of the public investor must be compared, must be at least the conduct of a private holding company or of a public holding or of a private group pursuing a structural policy whether general or sectoral, and guided by prospects of profitability in the longer term [3].

In the present case the Commission is of the opinion that, in the light of the particularly difficult financial position of Aer Lingus, no private investor would have accepted to invest equity in the airline.

The Irish authorities have decided to intervene at a particularly difficult moment when the airline, burdened by debts, was threatened with insolvency. In the light of Aer Lingus' financial weakness and liquidity crisis the intervention is aimed at rescuing the company and ensuring its survival.

Aer Lingus' financial situation and the structure and volume of its debts are such that no private investor, operating under market conditions, would have been able to expect a normal return on the capital invested within a reasonable time.

The aid, given the strong and lively degree of competition existing on most of Aer Lingus' routes, could distort competition between Community carriers. Moreover, the aid, given the cross-border characteristics of the sector involved, which by its nature is internationally orientated, affects trade between the Member States. This is particularly true for the United Kingdom-Ireland market, which was liberalized in 1986. The United Kingdom-Ireland market, which is the most important market for Aer Lingus, is characterized by very high traffic volumes and fierce competition. This is the geographical market where, because of its peculiarities, aid may have stronger repercussions on trade and on Aer Lingus' competitors.

Therefore the Commission is of the opinion that the projected equity injection into Aer Lingus, which has been notified by the Irish authorities as aid in accordance with Article 93 (3) of the Treaty, is an aid pursuant to Article 92 (1).

The aid to Aer Lingus cannot be considered as compatible with the common market pursuant to Article 92 (2) of the Treaty, since the aid does not correspond to any of the hypotheses provided under that provision.

(1) See Commission communication to the Member States concerning public authorities holdings in company capital of 17 September 1984, Bulletin of the European Communities 9-1984.

(2) See Commission communication concerning public authorities holdings, *op. cit.* Judgment of the Court of Justice in Joined Cases 296 and 318/82, The Netherlands and Leeuwarder Papierwarenfabrik v. Commission [1985] ECR 809, p. 823, paragraph 17.

(3) See judgment of 21 March 1991 in Case 305/89, Italy v. Commission, [1991] ECR I-1603, p. 1640, paragraph 20.

Article 92 (3) (a) and (c) provide for exceptions in respect of aid to promote or facilitate the development of certain regions. The Irish authorities maintain that the aid may be exempted pursuant to Article 92 (3) (a) as regional aid. This statement is based on the assumption that Ireland is within the European Regional Development Fund, an Objective 1 region, being a disadvantaged region with a per capita GDP below 75 % of the Community average. The Irish authorities argue that an efficient system of access transport is so crucial to the economy of the country that Ireland cannot risk becoming dependent on airlines based abroad. Should Aer Lingus fail to survive, the result would be devastating for the Irish economy in terms of access transport, industry, trade, tourism, employment, and the Irish aviation sector generally.

The Commission does not share the Irish authorities' opinion on the applicability of Article 92 (3) (a) to the aid to Aer Lingus. Even though Ireland is a region within the scope of Article 92 (3) (a), the aid under scrutiny is not a general scheme from which all the airlines based in Ireland, linking it with the rest of the world, may benefit. The aid is an *ad hoc* measure which helps the State-owned carrier to overcome its deep financial crisis and maintains Aer Lingus on the market. Therefore, Article 92 (3) (a) cannot be applied to the present case.

As regards Article 92 (3) (b) it is apparent that the aid is not intended to promote the execution of an important project of common European interest nor to remedy a serious disturbance in the Irish economy. In any case the Irish authorities have not invoked this provision.

With regard to the exception pursuant to Article 92 (3) (c) for 'aid to facilitate the development of certain economic activities', the Commission may consider some restructuring aid as compatible with the common market if it meets a number of conditions [1]. These conditions must be seen in the context of the two principles enunciated in Article 92 (3) (c) : the aid must be required for developing the activity from the standpoint of the Community and the aid may not adversely affect trading conditions to an extent contrary to the common interest [2].

These criteria have been interpreted in a sectoral (aviation) context in Memorandum No 2 which stipulates that the Commission may, in certain cases, decide in accordance with Article 92 that aid may be granted to individual airlines which have serious financial difficulties, provided certain conditions are met :

(a) the aid must form part of a programme, to be approved by the Commission, to restore the airline's commercial viability, so that it can, within a reasonably short period, be expected to operate viably without further aid ;

(b) the aid in question must not transfer the difficulties from that Member State to the rest of the Community ;

(c) any such aid must be structured so that it is transparent and can be verified.

In the context of increased competition, and in particular of the liberalization introduced in the Community in the air transport sector, following the adoption of the third package [3], the Commission must follow a strict policy of control of State aid to avoid any effects which would be contrary to the common interest.

The Irish authorities invoked the Article 92 (3) (c) exemption in favour of the notified aid. According to the Irish authorities the equitiy injection, forming part of a one-off financial restructuring package aimed at restoring the airline's viability within a short period, should benefit from an exemption as aid to promote the development of certain economic activities. This intervention would enable the airline to deal with the financial burden of the past and finance the necessary transition towards viability. Moreover, the financial restructuring would not affect trading conditions between the Member States to an extent contrary to the common interest. On the contrary, the aid will have the effect of preserving and promoting competition through the continuity of Aer Lingus and maintaining a high-quality and reliable air service between Ireland and the Community partners.

It is doubtless that Aer Lingus, like some other State-owned Community carriers, has been forced to create jobs, keep fares low and in general carry out obligations that the airline would not have assumed taking into consideration only its commercial interests.

[1] Eighth report on competition policy, point 176.
[2] See the Judgment of the Court of Justice of 17 September 1980 in Case 730/79, Philip Morris v Commission, [1980] ECR 2671.
[3] Council Regulations (EEC) No 2407/92, (EEC) No 2408/92, and (EEC) No 2409/92 (OJ No L 240, 24. 8. 1992, pp. 1, 8 and 15).

The criteria set out by Article 92 (3) (c) were systematically verified in order to assess the compatibility of the restructuring aid for Aer Lingus.

1. The Commission verified whether the aid was justified by the circumstances of the industry concerned.

The Community aviation industry appears, at the end of 1993, to have overcome the worst of the economic crisis which started with the Gulf war in 1990 and which has been further aggravated by worldwide economic recession. Most airlines are still experiencing a drastic downturn or stagnation of revenues and profits which has lasted much longer than expected. However, in 1992 passenger traffic increased by 14 % (AEA airlines) thereby recovering more than the loss in passengers of the previous year. This trend has been confirmed in 1993 when scheduled passenger traffic increased by about 9 % over 1992 figures.

Despite traffic growth most of the Community airlines' financial results are still unsatisfactory. One of the main reasons for this is that the aircraft ordered at the end of the 1980s, on the basis of over-optimistic forecasts, are now being delivered and put into operation. As a consequence, capacity offered has been growing faster than demand and therefore load factors are, for many airlines, still below the break-even point. In order to fill the seats offered, the airlines are compelled to offer promotional fares particularly during the winter season. The decrease in business traffic, which is a consequence of the general economic recession contributes to a large extent to the reduction of profits and is another reason for the poor results of most Community airlines.

However, the forecast for the aviation industry is, in the long run, quite positive. If the general economy manages to recover, better results are expected over the next two years. Overcapacity appears to be a temporary phenomenon which might be overcome around 1995. It is worth noting that some analysts even foresee, as a consequence of the growth in passenger demand and increase in the retirement of old aircraft in the 1990s, a capacity shortage by 1997 (1).

Therefore, the Commission does not believe that the aviation market of the Community is in a situation of general structural overcapacity; this conclusion is *a fortiori* valid for the United Kingdom/Ireland market, which was liberalized seven years earlier than the Community market, and is characterized by traffic levels higher than the Community average. At any rate for the restoration of Aer Lingus' financial and economic viability, capacity reductions are not required. In fact, the Aer Lingus fleet which consists, as mentioned above of 29 planes used for scheduled services does not appear excessive in view of the different markets reserved by the company.

As regards the common interest and in the light of the above, the Commission considers that the restructuring of Aer Lingus will contribute to the development of air transport activity in a peripheral area of the Community. The Commission acknowledges the importance of Aer Lingus, as the largest Irish air carrier, which has traditionally been entrusted with the task of ensuring the links between Ireland and the rest of the Community and between Ireland and United States. The information collected in the course of the Article 93 (2) procedure has enabled the Commission to consider that the plan is sufficiently well structured and aims at a radical restructuring of the airline, which will be beneficial for both the Irish economy and for the interest of the Community as a whole.

In the light of the foregoing, the Commission considers that the genuine restructuring of Aer Lingus contributes to the development of the air transport sector from a Community standpoint.

2. The Commission has verified whether the aid is linked to the restructuring of Aer Lingus.

The restructuring plan forwarded by the Irish authorities covers a short period, mid-1993 to 1995. The central objective of the plan is to focus Aer Lingus' activities on air transport by disposing of the other non-transport related activities. Should Aer Lingus succeed in carrying out the restructuring envisaged in the plan it should become an efficient carrier able to restore its long-term viability within a reasonable time. The aid consists of £ Irl 175 million to be paid in three tranches. Aer Lingus will use 75 % of the first tranche (£ Irl 75 million), to finance voluntary redundancies and the remaining part to reduce its outstanding debt. The payment of the second and third tranches are subject to the condition, imposed by the Irish Government, that Aer Lingus will achieve the cost reductions envisaged in the plan. Moreover the Irish Government has undertaken not to grant any other aid to Aer Lingus over the restructuring period. The Irish Government has also declared that they do not intend to grant any further aid in the future. Under these circumstances it is beyond doubt that the capital injection is directly linked to the restructuring of the airline.

(1) ESG Aviation Services, see article in *The Avmark Aviation Economist* of September 1993, p. 15.

3. The Commission verified whether the aid is proportionate to the problem which it is designed to resolve so that distortion to competition is kept to the minimum and does not affect trading conditions to an extent contrary to the common interest.

The amount of aid involved (£Irl 175 million) appears to be adequate and proportionate to the aim of financing the transition and restore the airline's commercial viability. £Irl 175 million will be used to finance voluntary redundancies and to reduce debts. The equity injected into Aer Lingus will not lad to an overcapitalization of the airline but will simply bring its financial ratios into more prudent limits and, therefore, restore the financial balance. The Aer Lingus group will mainly finance its own recapitalization through its own resources and, in particular, through the sale of the Copthorne hotels (1).

The strategy pursued by Aer Lingus in its restructuring plan is not over-expansionist. The Irish Government informed the Commission that the Aer Lingus group will not expand its operating fleet (as defined above) during the period of its restructuring and does not intend to change the general pattern of its operation over the same period. Aer Lingus does not, as the Irish Government confirmed, aim at increasing market shares and its operations will be profit orientated.

However, the Commission must ensure that the aid does not have certain adverse effects on Community trade by harming the competitive positions of some of Aer Lingus' competitors on the United Kingdom/ Ireland market. This market is currently operated at very high levels of capacity utilization and is characterized by the entry of new 'regional' carriers. Moreover, considering that the United Kingdom is progressively recovering from recession the medium and long-term traffic perspectives are optimistic for all the routes from and to the United Kingdom. This is particularly true for the United Kingdom/Ireland market which is ethnically orientated and where demand is very strong.

In the light of the above, and taking into consideration that because of fierce price competition, load factors on the United Kingdom/Ireland market are higher than the Community average, the Commission does not consider that this market is at present affected by overcapacity. The Commission does not share some of the third parties' allegations that the capacity levels on the United Kingdom/Ireland market as a wohle or on some of its routes are artificially high. According to these parties these routes would be affected by overcapacity if Aer Lingus did not continue its uneconomically low fare policy. These allegations are based on mere hypotheses and not on a thorough economic analysis of the demand. However, the Commission acknowledges that in a dynamic market, characterized by intense competition, the risk of overcapacity is always present. The Commission, thus, is of the opinion that the assurances given by the Irish Government are of such a nature as to prevent the aid being used, for example, to drive off smaller competitors or increase capacity to unacceptable levels on the Ireland/ United Kingdom market.

Therefore, the Commission takes note of the Irish Government's assurances that Aer Lingus will, for the duration of the restructuring programme, not increase capacity (expressed as number of seats offered), either on the United Kingdom/Ireland market as a whole, or on the Dublin-London Heathrow route, beyond the level realized in the 12 months prior to notification and that the money received will only be used as established in the restructuring plan. This does not preclude Aer Lingus from increasing the capacity should the traffic grow on that particular geographical market.

The Commission believes that the Irish Government's assurances are necessary conditions to prevent the aid affecting trading conditions to an extent contrary to the common interest and will enable Aer Lingus to compete fairly and freely in the common market, taking account of existing demand and future market growth.

4. The Commission verified whether its concerns expressed in its decision to open the Article 93 (2) procedure were well founded.

Apart from the issue relating to the effects of the aid on trade, which has been addressed above, the Commission is satisfied by the Irish Government's assurances on the other points set out in the letter opening the Article 93 (2) procedure. This decision is therefore adopted on the basis of the following assumptions :

— the cost reduction, as envisaged in the plan, is an essential condition of the payment of the second and third tranches of the aid,

(1) The restructuring should impact on the group's gearing ratio as follows : 499 % in 1993/94, 264 % in 1994/95, 75 % in 1995/96, and 41 % in 1996/97. The last two figures are mainly dependent on Aer Lingus' selling the hotels in the 1995/96 fiscal year.

— the cost reduction will be audited separately by an independent consultant,

— the company has reached and concluded an agreement with the unions on staff reductions,

— the new strategy pursued at Shannon Airport was freely chosen by the company and reflects its commercial considerations,

— the Irish Government will refrain from granting any other aid to Aer Lingus over the restructuring period,

— the corporate restructuring is not, under Irish law, subject to stamp and capital duty and this is not an individual or sectoral privilege in favour of Aer Lingus.

As regards ground handling at the Irish airports, the Commission, in the absence of Community legislation regulating this activity, is satisfied with the Irish comments and, in particular, with the fact that third parties are allowed to self-handle at Irish airports.

VI

In the light of the foregoing, the aid, in the form of an equity injection to be awarded by the Irish Government to the Aer Lingus group to support its restructuring programme, may benefit from the derogation provided for pursuant to Article 92 (3) (c) of the Treaty provided that a number of requirements are fulfilled to ensure that the aid does not adversely affect trading conditions to an extent contrary to the common interest,

HAS ADOPTED THIS DECISION:

Article 1

The restructuring aid to Aer Lingus in the form of £Irl 175 million equity injection to be awarded in three tranches in 1993, 1994, and 1995 is considered to be compatible with the common market pursuant to Article 92 (3) (c), provided that the Irish Government:

(a) fulfils its commitment not to proceed with the payment of the second and third tranches should Aer Lingus fail to achieve the £Irl 50 million annual reduction in costs, and obtains an independent verification that the cost reductions are implemented in full;

(b) fulfils its commitment to provide a report to the Commission on the progress of the restructuring programme, on the financial and economic development of the Aer Lingus group and its companies, in particular with regard to the productivity improvements as referred to in their letter of 24 November 1993. The report will be given at least four weeks before the payment of the second and third tranches of the aid in 1994 and 1995 in order to give the Commission, if necessary, the possibility to comment;

(c) fulfils its commitment not to grant any further aid either in the form of equity injection or any other form to the Aer Lingus group;

(d) fulfils its commitment not to expand Aer Lingus' operating fleet over the period of the restructuring plan other than for transatlantic operations where additional aircraft may be required to maintain capacity levels;

(e) fulfils its commitment that, if created, Aer Lingus Express shall operate within the framework of Aer Lingus' operating fleet;

(f) fulfils its commitment that under the restructuring, the European operations, the transatlantic operations, and if and when established Aer Lingus Express, will become and operate as separate legal entities with separate audited accounts which will allow for a transparent analysis of their various operations;

(g) fulfils its commitment that the number of seats offered for sale to the public on Aer Lingus' scheduled services will not exceed in the calendar year 1994, for United Kingdom/Ireland routes, 3,42 million seats as a whole and, for the Dublin-London Heathrow route, 1,43 million seats for the same year;

(h) fulfils its commitment that by agreement between the Commission and Ireland, independent assessors will be appointed in mid-1994 to review actual and prospective performance for 1994. If the growth of the Ireland/United Kingdom market so warrants, the figures set out in (g) will be adjusted to reflect such growth. At the same time, an independent assessment of actual and prospective market growth will be drawn up in order to determine Aer Lingus' additional capacity for 1995 in line with any increase in the total market;

(i) fulfils its commitment not to interfere in the management of Aer Lingus for other than commercial reasons;

(j) fulfils its commitment that Aer Lingus will refrain from acquiring shareholdings in any Community air carrier with the aid.

Article 2

The commitments provided for pursuant to Article 1 shall remain valid until 31 December 1995.

Article 3

This Decision is addressed to Ireland.

Done at Brussels, 21 December 1993.

For the Commission

Abel MATUTES

Member of the Commission