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REPUBLIC OF ESTONIA  
GOVERNMENT OFFICE

## ANALYSIS

### “Improving the functioning of the EU air services market”

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“Administrative capacity”, action 12.2 “Development of quality of policy-making”*



## TABLE OF CONTENTS:

1. Introduction.....	3
Purpose of the study .....	4
2. EXECUTIVE SUMMARY OF MAIN FINDINGS.....	4
3. Summary of Answers to Questions. ....	7
4. What are general possibilities available under EU law to promote connectivity (for the airport and for the state)? .....	9
Definition of connectivity.....	9
Connectivity of Estonia relative to other Member States .....	10
5. What are current possibilities used by other countries in the EU legislation to support the intra-EU connectivity (for the airport and for the state)?.....	14
6. Specificities of Estonia.....	15
Growth potential of inbound and outbound business traffic.....	15
Main competitors for business travel to/from Tallinn.....	15
7. Past measures of Estonian government to promote connectivity between Estonia and other EU Member States.....	16
8. Additional measures which could be taken by Estonian government.....	18
PSO from Tallinn to selected EU destinations.....	18
Promotion of the liberal air transport possibilities.....	23
Scenario analysis .....	33
9. Legal framework for measures to enhance connectivity within the EU .....	34
The State Acting as a Customer.....	34
The State Acting as an Entrepreneur .....	43
10. Suggested Legal improvements of the PSO legislation .....	74
11. Analysis of improvement of the current legal framework on state aid.....	76
12. Improving the legislation enabling the provision of other measures .....	78
13. Improvement of the operating environment in peripheral areas.....	79
14. Possible strategic steps to consider when implementing recommendations.....	79

## 1. Introduction

The Government Office of Estonia issued a tender for a study entitled “Improving the functioning of the EU air services market”.

The objective of the public procurement is to:

- (a) Provide legislative solutions for improving the functioning of the EU air services market; these would be used by the Estonian government to launch EU-wide discussions about legislative changes. Hence the government considers it essential that the proposed amendments take into account the opinions and experience of supporting Member States who could have the same concerns.<sup>1</sup>
- (b) Develop proposals for improving air connectivity between Estonia and main European centres<sup>2</sup>, based on the aim to ensure connection to pre-determined European capitals 5 days per week, 2 time a day (enabling day trips).

To achieve these objectives, the government expects a description of how other EU Member States in similar situations have sought to support the aviation sector with fiscal and non-fiscal measures, and to develop, based upon such benchmarks, up to 10 measures which could be used to improve air connectivity under the existing legislation, whilst taking due account of the cost of the proposed measures, and if necessary proposing appropriate amendments to the EU legislation<sup>3</sup>. The government specified more concretely its expectations in four questions<sup>4</sup>.

The Estonian government recognises the importance of connectivity for the Estonian economy, but sees that the Estonian air connectivity network is insufficient and has therefore set, in the Government Programme, the target to improve connectivity for the business and leisure travellers<sup>5</sup>. The government sees as main reasons for the lack of connectivity the country’s geographic location, the small catchment area, and the fact that the airlines will not mount operations to remote locations, or thinly served routes, but focus on larger markets; this has led to connections from Estonia to some European hubs, but the country lacks all year *direct* connections for business travellers<sup>6</sup>.

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<sup>1</sup> 2.2. of Public Procurement 178438

<sup>2</sup> 1.2. of Public Procurement 178438

<sup>3</sup> 2.3. of Public Procurement 178438

<sup>4</sup> 2.4 of Public Procurement 178438

<sup>5</sup> <https://valitsus.ee/en>.

<sup>6</sup> 2.1. of Public Procurement 178438

## Purpose of the study

The study seeks to achieve the objectives as laid out by the government by focusing on specific aspects in view of the foreseen time schedule.

To this end, the study defines connectivity, substantiates the government's evaluation of the status quo, and lays forth the general possibilities available under EU law to promote connectivity. The study provides a brief overview of the extent to which other Member States have made use of these possibilities, and determines the specificities of the Estonian market, so as to be able to assess which measures could also be considered as valid for Estonia, which measures have already been taken, and which additional measures should be considered under current and future EU legislation.

## 2. EXECUTIVE SUMMARY OF MAIN FINDINGS

- This study has compared the situation in Estonia with that of other Member States. Public Service Obligations (PSO) have been introduced by some of these Member States, but primarily to ensure domestic, not cross-border operations. Apart from these governmental measures, most if not all airports have introduced incentive schemes and marketing agreements to encourage airlines to open services; however some of these have been considered incompatible with EU law by the EU Commission.
- Further analysis is required to assess the impact of any reduction in the levels and nature of aviation related charges in Estonia with the aim of reducing the external cost burden on aviation activity at TLL; by lowering external costs for the airlines, TLL might be relatively more attractive to airlines seeking new opportunities although they would also consider other factors in the market such as the size of the catchment, disposable income and population. Article 5 of Regulation 300/2008<sup>7</sup> allows Member States to determine in which circumstances, and the extent to which, the costs of security measures taken to protect civil aviation against acts of unlawful interference should be borne by the State, the airport entities, air carriers, other responsible agencies, or users. In addition, according to the same legal framework, if appropriate, and in conformity with EU law, Member States may contribute with users to the costs of security measures which are more stringent than those imposed under Regulation 300/2008. taken under this Regulation. This has not been fully utilised by Estonian Government/ TLL, therefore there is potential additional opportunity to further support the incoming airlines by compensating security charges to the maximum permitted under the law.

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<sup>7</sup> Regulation (EC) No 300/2008 of the European Parliament and of the Council of 11 March 2008 on common rules in the field of civil aviation security and repealing Regulation (EC) No 2320/2002 OJ L 97/72, 9.4.2008

Although as a rule of thumb, airport taxes and charges account for only approximately 3-5% of the total cost of a traditional airline, but this is not the case for low cost airlines; given the reduced level of other costs, the level of tax-related costs and the costs for the security charges is a relatively higher percentage of the total costs. Furthermore the value of any airport incentive as a percentage diminishes over distance so this would be more of a deciding factor in shorter routes.

Broadly speaking, these cost factors can play a role for an airline's decision to begin services to Tallinn. Such measures would increase the attractiveness of Tallinn airport, prompt new entrants, and encourage incumbents to increase their operations to Tallinn. Given that the main object of this study is primarily to target connectivity for the business traveller, it would need to be determined however, if these measures would lead to the introduction of services at times of interest to the business traveller. It would also be an untargeted approach and may not result in services to the cities deemed important for business needs. In short, it is beneficial to all aviation actors, and more so to those with more services. Therefore, it is less likely to be challenged but it is also less likely to achieve in case of specific connectivity goals such as targeting primarily business traveller.

- Within the existing regulatory framework, Tallinn Airport is presently implementing many of the positive initiatives that we typically see in similarly situated airports. There are some enhancements and ideas one that could be considered to further their goals. This would only be fine tuning of what already appears to be a robust program and the ideas would be based on measures that have been implemented elsewhere and which have not been considered illegal by the Commission. For example, because of the political objective not only to increase traffic, but to secure viable connectivity for the business traveller, it may be necessary to consider trade offs if the airline is prepared to provide for all year services for a period longer than three years. Such rigorous promotional and marketing programmes would underline the rationale for the recent investments into the airport's infrastructure, which the Commission has approved.
- A further measure to enhance the impact of reliable air connectivity is the introduction of two Round Table initiatives.
- One Round Table focuses on national interests and brings together senior members of the government as well as the directly or indirectly affected private sector such as Tourism Bodies and Trade organisations in key areas such as the Hotelier Association, Convention Bureaus, Chambers of Commerce as well as unions and the airport and airline. A joint national marketing action plan should be the basis for such a national initiative which would evaluate the best means to promote connectivity by air connections through measures such as reduced fees and charges, relaxed night curfews, tourism incentives, additional measures to facilitate access from the airport to the city, public marketing campaigns, corporate backing and seat volume commitments and positive support for the aviation sector by multipliers.

- A second Round Table initiative has the objective of bringing together DGCA's and ultimately Ministers of like-minded countries facing similar if not identical challenges. Currently, several smaller Member States in the periphery of the European Union realize that, increasingly, connections are being reduced by market forces in sub-markets which are commercially less relevant and have insufficient demand to warrant the operation of profitable routes. This reduction of services, and thus connectivity, negatively impacts growth opportunities of national businesses and reduces the attractiveness of the country for international companies to establish themselves and/or regional headquarters in their respective countries. The Member States concerned are all grappling with these issues individually and largely separately. A Round Table initiative by Estonia could address the fact that the Member States have issues of common concern in the field of aviation. A common understanding of the issues will strengthen the resolve to address them together in a constructive dialogue with the EU Commission, and to base the discussions on commonly agreed concrete proposals to improve the connectivity levels.
- The current PSO provisions are no longer fit for purpose. They were developed to enable Member States to provide for air connectivity to remote regions in their respective domestic territory. In the wake of the Single European Aviation Market, the national markets have gradually „grown together“. PSOs must now also be feasible within the EU without undermining the liberalised competition in this enlarged Single Market. Member States with a small population base and/or situated on the periphery of the European Union, cannot rely on market forces to build a viable air connectivity infrastructure to meet the needs of business, and in some cases leisure traffic, on an all year basis. The absence of planning stability impacts growth perspectives for businesses, and curtails economic growth.

The PSO provisions must therefore be altered to enable Member States to offer PSOs for a currently underserved route or several routes within the European Union which a government considers to be of strategic importance for the nation's economy. If several routes are bundled into such a PSO offer, the provisions should not preclude competitors from accessing individual routes. Thus, the modifications would not stifle competition and, to the contrary, incentivize even further market activity on the routes in question.

- Such a political initiative to modify existing legislation is most likely to be successful if it is supported by other Member States, notably of those in a similar dilemma. We therefore suggest considering an initiative to discuss these findings with such Member States in an informal workshop to jointly determine how best air connectivity can be promoted within Europe in currently underserved sub-markets. Such a workshop would create an even broader awareness of the vital issues the Estonian government is addressing; as a consequence, the „Estonian initiative“ would be perceived as an issue of EU-wide relevance. Estonia would then no longer be speaking pro domo, but together with other

Member States about the context of securing reliable connectivity. We would be happy to facilitate such a dialogue with other Member States if so desired.

### 3. Summary of Answers to Questions.

*Q1. What are the current possibilities, used by other countries, in the EU legislation to support the intra EU air connectivity (for the airport and for the state)? Has Estonia used all the possibilities (including budget and non-budget measures as well as general environment and contextual measures), regarding EU legislation to strengthen better air connectivity between Estonia and other EU States?*

The measures foreseen by EU legislation range from Regional Funds, Route Development Funds, PSOs to State aids for airlines and/or airports in accordance with the State Aid Guidelines. Of these measures, the benchmarked Member States have made use of State Aid for airlines, and in some cases PSOs for domestic routes; no EU funds were sought for regional development purposes.

The policy in all of these cases was to “make the bride attractive“ and seek to execute a transaction involving the airline and/or the main airport and a strategic or financial investor. None of these measures had the primary goal of strengthening connectivity. Instead, they were focused on maintaining the operational viability of the (new) airline with the hope for the consequential gradual growth of demand that follows. National concerted efforts by the private sector to finance further measures were not coordinated or sought by other Member States.

Therefore, the stated aim of the government to promote connectivity as a matter of policy is unique in our experience; this has not been found in any other document of the benchmarked Member States.

Under the current PSO regime the legally foreseen tender might not respond to the need for network connectivity which includes key destinations. This is because the concept of tendering a group of PSOs is very limited. Even if the Commission accepted a network of connectivity under an SGEI separately from a PSO, there remains the major issue of restriction to a cost compensation. Furthermore, any SGEI approach requires (in order to fulfil the requirement of legal certainty) a proper tender process as well. These same restrictions would apply even if the PSO legislation was amended in order to include the concept of network connectivity for peripheral states.

We caution that, in view of the market as it currently functions, such a policy could be challenged by other parties, both LCCs and the nations hosting the established hubs. If one were to proceed openly down this path, it would require a robust business and legal case to ensure its compliance with current EU legislation, and at least be based upon appropriate clarifications of EU policy and/or legislation.

*Q2. What measures could be additionally taken (taking account Estonian market situation) to ensure sufficient connectivity between Estonia and EU states?*

Currently, a significant portion of the European business traffic flows via nearby hubs (notably Riga, Stockholm and Helsinki). Further afield, other hubs such as Warsaw, Copenhagen, Oslo, Amsterdam, Munich and Frankfurt all take fragments of the TLL market. Each of these hub airlines can employ marginal pricing to carry incremental traffic to numerous final destinations beyond their base. There are of course a number of limited frequency, direct routes from Tallinn. Given the proximity of the adjacent hubs, the small outbound business market will not sustain additional airline operations from Tallinn exclusively for the business traveller. At the same time Easterly and Northerly 'beyond' traffic and the associated hub economics are limited by competition from established operators, pure geography as well as the political and economic situations in neighbouring countries. Current legislation does not enable offering a bundle of PSO routes es TLL and still not prohibiting non-Estonian airlines from competing on individual routes of that PSO bundle. Next to legislative changes in this field, it is worthwhile considering to adopt further market stimulation measures by TLL, it being understood that the airport already has a scheme in place, and that such a scheme benefits all carriers which are interested.

Specifically with regard to marketing agreements, an increased trend to attract airlines is through a specific type of marketing agreement whereby the airport or region pays the air carrier financial compensation for the provision of marketing services by promoting the airport or region. While the Commission has not accepted that such an agreement can constitute a genuine marketing agreement, it has in several cases accepted that these did not constitute State aid. This was on the basis of the MEO test applied jointly to the respective marketing agreement and the airport services agreement with that air carrier. When such marketing agreements are concluded between another body, other than the airport operator and the air carrier, the test applied by the Commission is first to check whether the service meets the actual need of the public purchaser.

*Q3. What is the indicative cost for implementing additional measures to ensure connections to preferred destinations from Tallinn to Europe 5 times a week and twice a day (enabling day trips) for business travelers? Benchmarking between current and preferred options. (Necessary information on routes and travelers data will be made available to the service provider). What are the costs for the state to improve destinations from Tallinn Airport to London, Amsterdam, Brussels, Vienna, Zurich five times a week and twice a day (more than a 70 seat aircraft)? Same calculations with the routes from Tallinn to Hamburg and Goteborg (max 70 seat aircraft)?*

Please find the evaluation of the costs and the underlying assumptions attached as Attachment 1.

*Q4. How can existing EU legal framework be improved to ensure better functioning of the EU air services market? The analysis should concentrate on concrete amendments to:*

- *Improve the legislation on state aid for airports.*
- *Improve the PSO legislation.*



- *Improve the operating environment in peripheral areas.*
- *Improve the legislation enabling the provision of other measures.*

The provision of other means to generate or stimulate traffic is generally undertaken by airports either directly, or in conjunction with tourism promotion authorities and/or trade bodies and local communities. The EU Commission has, over time, developed case law determining the conditions under which such promotional measures are compatible with current law. Given the now firmly established principles that exist, it seems extremely unlikely from a political viewpoint that these could be modified to grant exceptional rights to peripheral airports. Likewise, legislation state aid for airports, which in 2014 saw a review of the relevant EU Guidelines, will not be significantly modified in the foreseeable future.

However, the PSO legislation provides for room for improvement as these are currently aimed at facilitating Member States' objectives of providing for air connections on underserved domestic routes. The definition of "domestic" has however been changed by the creation of a Single European Aviation Market, so that the PSO legislation should reflect the need for offering several routes to key EU destinations on condition that this does not exclude competitors from operating on individual routes.

The operating environment in peripheral areas can be significantly enhanced if the national bodies directly or indirectly involved in air transport, such as local communities, trades bodies, the airport, the airline, and unions were to jointly identify the benefits which the promotion of air connectivity can bring to the national economy. This could take the form of private financing of measures to increase the attractiveness of Tallinn and other destinations for business and leisure purposes and political initiatives with like-minded other peripheral countries to jointly strengthen their influence on the decision-making process in Brussels.

#### **4. What are general possibilities available under EU law to promote connectivity (for the airport and for the state)?**

##### **Definition of connectivity**

Generally, connectivity is defined as the number of connections from a given airport to other commercially used airports. This definition is, however, considered to be too crude to enable any relevant analysis for the communities and the operators; several factors determine the quality of such connections and hence affect the expected revenue streams for airports, communities, and airlines. Furthermore, airlines have different business models, with varying degrees of impact on the connectivity and planning stability of regions.

"Connectivity" is therefore an element which combines the infrastructural aspect of aviation with its economic impact. To evaluate the impact of lost or new routes on the air networks of a city or region, an index has been established which focuses on factors such as

- The importance of the destination as a business destination
- The convenience of the destination (with respect to the city center) and
- The frequency of the service.

Airlines generally use the IATA connectivity measure which ranks in accordance with the best-connected airport, as opposed to its weighted importance for business.

ICAO recently published a study on connectivity<sup>8</sup> which combines market and policy factors affecting connectivity<sup>9</sup>. Its “mathematical models can empirically explain and relate the current and forecasted demand on a route to evolving policies, competitive strategies, increasing connectivity and the optimisation of the air transport network.” The results of the project will be made available as a visual interactive decision support system (DSS) to ICAO Member States, and thus identify areas where market forces provide potential opportunities to States to further increase connectivity through appropriate policy initiatives and addressing constraining factors.

### **Connectivity of Estonia relative to other Member States**

The government has already highlighted the insufficient connectivity levels of Estonia relative to European peer countries. Several proposals will be outlined below to demonstrate that through structural changes and financial incentives connectivity can be improved. However, each of the measures proposed has an inherent risk: either the measure will come at a cost for the government (state aid, PSO), and/or contains legal risks or uncertainties (PSOs, measures to stimulate traffic to Tallinn).

We suggest the government pursues the concept of a connectivity index. In its Aviation Strategy paper, the Commission acknowledged the importance of measuring connectivity as the means of promoting economic growth through efficiently used and connected infrastructure. Several indices have been developed, as outlined above. They are a tool to estimate the impact of lost or new routes on the air networks of a city, country or region. The formula has the effect of measuring and comparing such added or lost value of routes. The index thus enables comparisons of the level and density of connections to important destinations.

However, the Commission has so far not outlined which index would be used for which purpose. This is highly regrettable, because this Report outlines measures undertaken by benchmarked countries, but cannot rank Estonia’s connectivity, based upon a neutral set of criteria relative to other Member States.

The connectivity index would substantiate and “measure” our findings that connectivity levels are high in the “economic power houses of centrally located larger economies, and less developed in peripheral smaller countries; such comparisons are not merely relevant as statistical tolls, they can be used as a basis for regional development policy, thereby linking the ranking within the

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<sup>8</sup> Preliminary Study of Air Connectivity and Competition. An Air Transport Diagnostic Project of ICAO and the Interdisciplinary Center for mathematical and computational Modelling ICM

<sup>9</sup> Air carrier ownership and control, liberalisation of traffic rights, cross ownership of aviation verticals, taxation and charging policies, lack of infrastructure, night and noise curfews.

Connectivity Index to the appropriateness of state aids, the need for PSOs, and access to EU Regional Funds.

Given that the Commission has indicated its intention to further develop the concept of a connectivity index, time has come for Member States to call on the Commission to do so and thereby provide for means for peripheral countries to promote connectivity without distorting competition.

### *General possibilities available under EU law to promote connectivity*

In its EU Aviation Strategy<sup>10</sup>, the EU Commission takes a holistic view on aviation and thereby underlines its economic, political, regulatory, infrastructural, environmental, international and social relevance. Promoting air connectivity therefore gains relevance as a factor for society in general, and not only as a factor for improving the performance and efficiency of a mode of transport. In this broader sense, EU law provides for several possibilities to promote connectivity by increasing the likelihood that airlines would seek to operate between particular points; the list of measures would include an increase of cost efficiency of the airport and Air Navigation Service Provider to reduce the fees and charges for airlines operating to/from Tallinn; measures to increase the attractiveness of the access from the city to the airport by public modes of transport; a reduction, to the degree legally possible, of night curfews and noise limitations; a liberal policy of negotiating traffic rights with Third Countries.

However, the benchmarked countries have not shown signs of seeking to introduce such additional measures to promote connectivity. They have thus been discarded in the following list of measures.

In essence, the measures which have been used and which create or improve connectivity and are as such measurable, can be summarized as follows:

#### **Public Service Obligation (PSO) Designation**

Many air transport routes that a country needs as part of its general interest are commercially unsustainable, but socially vital. In order, therefore, to maintain vital air links, the relevant Member State must be able to make sure they are provided and this historically has been done by granting exclusive rights to the air carriers flying those routes and remunerating them financially.

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<sup>10</sup> COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS An Aviation Strategy for Europe COM/2015/0598 final

The PSO routes concept is an exception to the general EU open market rules on the provision of intra-community air services and is, therefore, subject to strict requirements and limitations.<sup>11</sup>

Under Article 16 of Regulation 1008/2008, a PSO can be imposed by a Member State in respect of scheduled air services:<sup>12</sup>

- between an airport in the EU, and an airport servicing a peripheral or development region in its territory; or
- on a thin route to any airport on its territory;
- Where such route is considered vital for the economic and social development of the region which the airport serves.

Member States enjoy a margin of discretion when making such assessments. Generally an indispensable route for the survival of a region such as a small island will be considered to be vital. However, the Commission's draft Guidelines on the applicability of PSOs for any route recognise that routes linking small or medium sized cities to important economic or administrative centres could also be vital for a region and can satisfy the Article 16 requirements.<sup>13</sup> This could, in theory, include routes linking airports in the Baltics, such as in Riga, Tallinn, or Vilnius to airports in other Member States.<sup>14</sup>

The Commission does not take a formal decision on a Member State's imposition of a PSO. Publishing the information notice in the OJEU simply has the purpose of informing the market of the new PSO. Therefore, this will not provide any legal certainty to the PSO operator or Member State.<sup>15</sup> Fundamentally, a PSO should only be imposed by a Member State to the extent necessary to ensure on that route the minimum provision of scheduled air services satisfying fixed standards of continuity, regularity, pricing or minimum capacity which air carriers would not assume if solely considering their own commercial interests. Therefore the risk exists that financial support for the operation of the route could constitute State aid, if the imposition of the PSO does not meet all applicable EU requirements.

The right to provide PSO services must be subject to a public tender, as provided under Article 17 of Regulation 1008/2008. Furthermore, in order to avoid falling under the EU State aid

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<sup>11</sup> Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (Recast), OJEU L 293, 31.10.2008, p. 3-20, Article 15

<sup>12</sup> Scheduled air services are defined under Article 2(16) of Regulation 1008/2008 as flights for which on each flight seats and/or capacity to transport cargo and/or mail are available for individual purchase by the public and which are operated so as to serve traffic between the same two or more airports, either according to a published timetable, or with flights so regular or frequent that they constitute a recognisably systematic series. Non-scheduled air services are not effected by PSOs

<sup>13</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 24.

<sup>14</sup> Draft Commission guidelines on the application of PSOs for air routes, footnote 23.

<sup>15</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 13. These draft guidelines were circulated to stakeholders to provide comments between June and September 2016. There may still be significant amendments to these guidelines before the Commission publishes the final version thereof.

legislation, or to be held compatible with the internal market under this State aid legislation, financing the operation of a PSO route must be in accordance with the EU SGEI legislation. To avoid falling under the State aid rules altogether, public funding must fulfil the *Altmark* criteria. An explanation of the EU SGEI legislation and the Altmark criteria can be found below in Section 7. If these criteria are not met, the Member State's financial support for a PSO route will constitute State aid, but can be held to be compatible with the internal market under Article 106(2) TFEU.

For further details of the legal framework, please see Section 7 below.

*i. The possibility of having PSO for multiple routes*

Under the EU legal framework (Articles 16 and 17 of EC Regulation 1008/2008), it seems that it is not possible for a Member State to impose one PSO for multiple routes (except when it concerns connecting flights). However it is possible to have a single tender for multiple PSO routes, whereby a group of PSO routes are tendered for operation by a single air carrier.

Given that the government is seeking to secure viable operations on a group of routes to/from Estonia and on the basis that Regulation 1008/2008 does not expressly exclude the possibility of imposing a single PSO on multiple routes, it is strongly recommended to pursue the avenue of seeking clarification from the Commission as to whether a Member State can, within the current legal framework, impose a single PSO in respect of multiple routes. In case of doubt, a political initiative is recommended, together with other likeminded Member States to clarify the legislation so as to enable such a group of routes to be tendered under the PSO provisions.

*ii. State aid*

There are various ways through which a Member State can provide State aid within the EU legal framework.

First, when the State acts in accordance with the market economy operator test (“**MEO test**”), then any public financing will not constitute an “advantage” as provided under Article 107(1) TFEU<sup>16</sup>, and therefore will not be subject to the EU State aid rules. The application of the MEO test will determine whether the State acted on the market as a similar private economic operator would have done under normal market conditions.

Second, where the MEO test cannot be satisfied, the State aid rules provide other ways through which a State can provide public funding. The most important is aid for the development of

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<sup>16</sup> This Article contains the general definition of State aid: “Save as otherwise provided in the Treaties, 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.”

certain economic activities or areas under Article 107(3) (c) TFEU. Investment aid and operational aid to airports, and start-up aid to air carriers provided by the Estonian government can be justified under Article 107(3) (c) TFEU, provided that the conditions set out in the Aviation Guidelines have been adhered to.

Details of the legal framework are outlined below.

## **5. What are current possibilities used by other countries in the EU legislation to support the intra-EU connectivity (for the airport and for the state)?**

A review of selected benchmarked countries reveals that in all cases, the governments sought primarily to re-establish the profitability of the national airline. To this end, management was entrusted with the task of restructuring the airline. When this failed, the governments injected State aid, subject, evidently, to the Guidelines on State Aids for Airlines and Airports. In four cases, Lithuania, Estonia, Cyprus and Hungary, the national airline did not withstand the competitive market pressure despite the restructuring aid and folded. In one case, Slovenia, the airline (and airport) were sold to financial investors. State Aid has, in general, therefore not proven to be generally a measure which could establish connectivity reliably, nor had this been the intention. The primary focus had been in all benchmarked cases to address the financial situation of the airline. Estonia is the only Member State we are aware of with the stated primary policy of improving connectivity.

A further measure to improve connectivity is the introduction of PSOs. These have, in the review, shown to be of limited relevance for the Member States and the national airline. The notable exception is Cyprus; the PSO from Larnaca to Brussels is served, however, by Ryanair. None of the other benchmarked Member States have introduced intra-EU PSOs with the aim of improving connectivity; some have domestic PSOs to maintain domestic connections.

Other than these two tools, no benchmarked Member State has introduced a policy of measures to enhance connectivity. In fact, aviation is considered to be a given, and subjected to taxation or fees and charges for the use of the infrastructure, but not as a means of securing economic growth.

By addressing the need for reliable air connectivity, Estonia has therefore assumed leadership for a political objective.

That said, measures have been introduced in the market to stimulate demand, and thus secure the survival of the national airline. These measures essentially consist of special offers by airports and/or communities in the vicinity of airports interested in attracting additional services by airlines, not necessarily only of the national airline.

We have listed these measures at a generic level and to the degree possible, broken them down to measures taken by the benchmarked countries, as a possible avenue to pursue to promote aviation to/from Estonia.

## 6. Specificities of Estonia

### *Traffic data to/from Tallinn; market share of national carrier.*

The largest markets to/from Tallinn (local traffic) are depicted in the chart below:<sup>17</sup>

The source of data is Sabre, which is objective and unbiased. It shows that in the past 12 months, traffic was flown to major destinations to/from Tallinn by competing airlines. They would not be flying such routes if it did not make commercial sense. This underlines the importance of substantiating the need for PSOs.

### *Attractiveness of Tallinn vs other hubs in vicinity of Estonia for business travel*

Traffic flows have been established by main competitors from hubs in the vicinity, notably SAS, Finnair and airBaltic. These hubs have enabled the airlines to combine traffic from Tallinn and transport that traffic to beyond-markets. The traffic flows indicate that the demand has accustomed itself to the use of other hubs either for local traffic purposes or for beyond destinations. It will be a challenge to change the behavioral patterns of demand, given the smaller economy and population base in Estonia.

### Growth potential of inbound and outbound business traffic

Even if the growth rate was greater than 5%/pa, which would be deemed significant, it would not justify the type of capacity proposed. The seasonality of tourism to Estonia also impacts this equation since an Estonian airline will need to sustain economically viable traffic during the weaker winter months.

### Main competitors for business travel to/from Tallinn

Nearly every airline flying to TLL carries a component of business traffic and this would include the LCC's, although to a lesser extent than traditional carriers. Most airlines depend on a mix of passengers to make a route profitable. There are very few routes globally that are profitable solely on government and business travel requirements.

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<sup>17</sup> Source; Sabre. Data is classified in this version of the report in accordance with the Public Information Act, for internal use on the basis of clause 35 (1) p 17 (business secret).

## 7. Past measures of Estonian government to promote connectivity between Estonia and other EU Member States

Based on publicly available information, we have been able to establish that various measures have already been undertaken in the past by the Estonian government to promote connectivity between Estonia and other EU Member States.

### *i. PSOs*

Based on the overview of PSOs made public by the European Commission at the end of 2015 it has been noted that Estonia has implemented the following PSOs:<sup>18</sup>

Airport 1	Airport 2	Begin date	End date	Geography	Market access
Kuressaare	Tallinn	1-May-2012	1-May-2017	Island	Restricted
Kärdla	Tallinn	14-May-2014	13-May-2018	Island	Restricted
Pärnu - Ruhnu	Kuressaare	1-Nov-2010	30-Apr-2015	Island	Restricted
Kihnu	Pärnu	15-Dec-2014	30-Apr-2016	Island	Restricted

The list contains former PSOs in Estonia that have now expired. However, it seems that this overview does not cover PSOs that ended before 2015. Therefore this list does not cover the former PSOs implemented by Estonia in an exhaustive manner given that recently due to the bankruptcy of the previous operation of Tallinn – Kuressaare and Tallinn – Kärdla routes, new PSO's have been established for these routes in the benefit of Transaviabaltika from 20.06.2016 until 31.05.2019.

### *ii. Investments into national airline and airport*

#### Investments into national airline

In September 2010, the Estonian Ministry of Economics and Communication injected 17,9 million euros into the capital of Estonian Air and acquired 90 % of the share capital. SAS Individual Holdings AB held 10 % of the shares.

In November 2011, the Estonian government decided to invest additional 30 million euros into the share capital of Estonian Air. The capital injection was carried out in two equal parts of 15 million euros (the first one in December 2011 and the other in March 2012). Since that, the Republic of Estonia held 97,34 % of the share capital.

The 2011 business plan was based on a hub structure and regional network model. It aimed to increase the connections to and from Tallinn airport.

In view of the losses in mid-2012 and due to the hardships of kick-starting the hub-and-spokes strategy, the Estonian government decided in December 2012 to provide rescue-loan to Estonian Air in the amount of 8,3 million euros in two instalments (in December 2012 and in January

<sup>18</sup> See

[https://ec.europa.eu/transport/sites/transport/files/modes/air/internal\\_market/doc/pso\\_routes\\_dec\\_2015.pdf](https://ec.europa.eu/transport/sites/transport/files/modes/air/internal_market/doc/pso_routes_dec_2015.pdf).



2013). In February 2013 the Estonian government decided to increase the rescue loan by 28.7 million euros. In March 2013, 16.6 million euros were granted and the additional 12.1 million euros in November 2014. The total rescue loan facility was therefore in the amount of 37 million euros.

In June 2013, the Estonian government notified the European Commission of the restructuring aid (equity injection) to Estonian Air in the amount of 40.7 million euros, on the basis of a restructuring plan covering a five-year restructuring period from 2013 to 2017. The restructuring plan was modified in October 2014. The modifications of the plan related *inter alia* to the planned acquisition of 90-100 % of Estonian Air shares by a the Estonian investment group Infotrar.

On the 6th of November 2015, the European Commission issued a negative decision, according to which the capital injection of 17.9 million euros in 2010, 30 million euros in 2011-2012 and rescue loan amounting to 37 million euros was unlawful and incompatible State aid and should be recovered from Estonian Air. The planned but not implemented restructuring aid in the amount of 40.7 million euros was also declared incompatible.

In September 2015, the state decided to invest 40.7 million euros in the new airline company Nordic Aviation Group (brand name Nordica in 2016) and 32 million euros in the asset company OÜ Transpordi Varahaldus. OÜ Transpordi Varahaldus owns 4 aircraft (Bombardier CRJ 900 NextGen) which it leases to Nordic Aviation Group.

#### Investments into airport

In last 10 years, over 100 million euros have been or is being invested to increase the capacity of Tallinn Airport and indirectly also the connectivity. The terminal was enlarged in 2006-2008. In May 2016, a large-scale construction work began on the air traffic area: lengthening the runway (making it the longest runway for civil aviation in the Baltic States); the reconstruction of the existing runway's protective structure and the replacement of its lighting system; improvements to taxiways and the aircraft platform area system. The terminal area will be enlarged again by 2018 and the tramway from airport to city will be completed in 2017.

For the following measures the Estonian government has made use of the possibility to act as an entrepreneur, as it was held that the measures financing infrastructure at Tallinn Airport did not constitute state aid under Article 107(1) TFEU:

- Rehabilitation of Tallinn Airport Airside Area – 2007 (N379/2006).<sup>19</sup>
- Upgrading of Tallinn airport passengers' terminal and phyto-sanitary and veterinary border inspection point according to EU demands – 2007 (N380/2006).<sup>20</sup>

For the following measure the Estonian government also has made use of the possibility to act as an entrepreneur, as it was held that the aid financing the modernisation of infrastructure at Tallinn Airport was compatible with the internal market under Article 107(3)(c) TFEU:

- Tallinn Airport airside area development project – 2015 (SA.39315).<sup>21</sup>

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<sup>19</sup> See [http://ec.europa.eu/competition/state\\_aid/cases/215551/215551\\_717413\\_23\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/215551/215551_717413_23_2.pdf).

<sup>20</sup> See [http://ec.europa.eu/competition/state\\_aid/cases/215552/215552\\_717401\\_22\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/215552/215552_717401_22_2.pdf).

## 8. Additional measures which could be taken by Estonian government

### PSO from Tallinn to selected EU destinations

As noted above, a significant portion of the local market traffic flows to/from Tallinn via nearby hubs (notably Riga, Stockholm and Helsinki).

In seeking to establish 10 flights/week on the following routes to/from Tallinn, we believe the following considerations will be relevant:

1. Vienna – one would need to double capacity and still hope that Air Baltic would forfeit their position on the route which would seem unlikely.
2. London – at present the schedule envisaged would have assumed a multifold increase in demand beyond the twice weekly easyJet service. There is no certainty that easyJet would withdraw which would take away a large portion of the leisure traffic which forms a key component in the mix of passengers need to fill a flight as business traffic alone cannot sustain a flight.
3. Brussels – the proposed frequency increase is not as dramatic as the other cities noted though in terms of seat capacity would still represent significant growth based on aircraft gauge. We should point out that any new initiative should be considered with the period after the upcoming Estonian EU presidency in mind.
4. Amsterdam – At present there are 14 flights per week divided between two carriers, Air Baltic has a code share with KLM who operates one of Europe's strongest hubs and would be the party more likely to be able to sustain a second weekday flight.
5. Zurich – we are unable to identify evidence of significant demand
6. Gothenburg – we are unable to identify evidence of significant demand.
7. Hamburg - we are unable to identify evidence of significant demand

Since we think it is unlikely that a persuasive business case can be made for the 10 flights per week service levels envisaged to these markets, we can consider PSOs are currently designed to secure primarily domestic routes, but as noted, we suspect the only route that might meet present criteria would be to Strasbourg or Brussels.

If drafted carefully in an EU-conform manner, PSOs could constitute pillars for connectivity. This does not necessarily, however, have to be beneficial for the national carrier<sup>22</sup>, as any Community air carrier would be entitled to bid. Given the thin markets in question, these routes need to be promoted and marketed by the private sector as an Estonian branding initiative to generate growth for inbound business and leisure travel.

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<sup>21</sup> See [http://ec.europa.eu/competition/state\\_aid/cases/259256/259256\\_1706255\\_53\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/259256/259256_1706255_53_2.pdf).

<sup>22</sup> The PSO from Larnaca to Brussels was awarded to Ryanair

*i. The regulatory framework*

PSOs can be imposed as long as they meet the substantive and procedural conditions set out in Article 16 to 18 of Regulation 1008/2008.

Under the substantive requirements, a PSO can only be imposed on scheduled air services considered vital for the economic and social development of the region between an airport in the EU, and an airport servicing a peripheral or development region in its territory; or on a thin route to any airport on its territory.

Regarding the procedural aspects, Regulation 1008/2008 sets out detailed rules to be followed imposing a PSO on a particular route, and also the procedure to be followed when financing the operation of a PSO when no air carriers operate it of their own accord. With regard to the latter, Article 17 sets out a public procurement procedure to be followed.

Furthermore, in order to avoid falling under the EU State aid legislation, or to be held compatible with the internal market under this State aid legislation, financing the operation of a PSO route must be in accordance with the EU SGEI legislation.

Details of the applicable legal rules can be found below under the general overview of the EU legal framework.

*Indicative cost for implementing additional measures to ensure connections to preferred destinations from Tallinn to Europe 5 times a week and twice a day (enabling day trips) for business travelers. Benchmarking between current and preferred options.*

We have analysed the network proposed and have provided the attached indicative cost structure. It is missing a few key cost elements (that in total could add +/- 10% though this would have to be considered on a market basis to provide an exact assessment). Still, we believe this should give an approximate overview of the capital required to operate the airline over the course of a year.

We are concerned that the network as originally proposed in the briefing questions is not likely to return a profit. Certain routes highlighted are difficult to justify, even with a reasonable amount of market stimulation. Others can be operated but possibly not with the level of frequency envisaged during the developmental stages of the airline. We would also be concerned about the inefficiencies of operating two different fleet types in such a small airline as it requires two subsets of pilots, engineers, spare parts etc.

Still, there is a business and leisure market ex-TLL. If one was to develop an airline based on connectivity with the ambition to achieve sustainability, we suggest to start with a slightly smaller fleet and balance the utilisation with market demand.

As an example:

- Zurich would likely be considered a developmental route and one might consider using spare capacity (perhaps in the midday between one's morning and evening returns) to see even if at one per day, there is sustainable market demand.
- Gothenburg and Hamburg could also be trialled midday on limited frequency to see if there is demand. We would be reluctant to suggest acquiring a different (<70 seat) aircraft type to cover just a few routes for an airline of this size due to reasons previously noted. It may be better to simply reduce frequency.

In addition, it would not be sensible to use an aircraft that is smaller than 70 seats for this type of route. The ATR-500 would be the usual aircraft for 'thin routes' but in this case, the sector length is just too long. GOT is 755km and HAM is 1,114 km from Tallinn. The flight times would be 2 hours 5 minutes and 2 hours 50 minutes respectively. Although in range for the aircraft, most airlines try to restrict turboprop flying to about 1 hour 30 minutes maximum flying time. In excess of 2 hours would be very unusual both because of aircraft economics and passenger comfort issues.

- On other routes, even a slight amount of capacity rationalisation might help improve financial performance. As an example, there would be very little demand for Brussels on a Friday morning due to the nature of the flows in that market but one might be able to make another route better suited for the Friday morning slot, and then fly BRU-TLL on Friday afternoon.

Optimising the network, fleet and frequency so achieve greater viability would require more time and detailed analysis than the present assignment allows for. Still, such optimisation might allow an airline to operate on a fleet of less than 5 aircraft and accomplish many of the noted goals while trying to keep costs in check.

*Costs for the state to improve destinations from Tallinn Airport to London, Amsterdam, Brussels, Vienna, Zurich five times a week and twice a day (more than a 70 seat aircraft). Same calculations with the routes from Tallinn to Hamburg and Goteborg (max 70 seat aircraft).*

Please see Appendix 1 for high-level estimation.

### **Grouping of routes to form a network**

This section will cover the possibility for Estonia to finance air carrier(s) for the operation of a group of routes through a PSO or group of PSOs, and a potential alternative through which we

believe it may be possible to finance a network of routes as an SGEI subject to the general EU public procurement legislation.

*i. Single PSOs*

It is possible for Estonia to establish PSOs for individual routes, subject to Regulation 1008/2008. However, although the use of PSOs on single routes can constitute pillars of connectivity, it is difficult to coordinate such individual routes to contribute towards to general aim of improving connectivity of a given region or Member State.

A more effective way to coordinate a network of routes would be to impose a single PSO on a group of routes. However, as it stands, the PSO legislation does not expressly permit bundling a group of routes forming a network under a single PSO.

*ii. Tendering multiple PSO routes*

Article 16(10) of Regulation 1008/2008 allows multiple PSO routes to be tendered under a single tender. In practice this means that a Member State could grant exclusivity to one carrier for a group of PSO routes.

However, this is only possible where justified for reasons of operational efficiency. Therefore, the reasons for grouping must be of an operational nature (*e.g.* necessity of an operational base in a remote area) and may not have as main objective to reduce the budgetary impact on the Member State. In this context, grouping profitable and unprofitable routes without operational commonalities is not possible.

Such grouping may have a limiting effect on competition since exclusivity is granted to one air carrier for the operation of multiple PSO routes, and access to these routes will, therefore, be limited. Under these circumstances, it can be expected that the Commission will not easily accept tendering a network of PSOs under a single tender for the purpose of improving air connectivity.

*iii. Tendering a network of routes as an SGEI*

Under the current PSO legislation there is nothing that expressly permits bundling routes to form a network for the purpose of improving connectivity. An alternative, however, could be to finance the operation of a network of routes as an SGEI subject to the general EU public procurement legislation. It is important to note that this is a novel and untested model, and therefore it must be discussed with the Commission before being put to practical use.

In this context, a Member State could potentially enter into a public service contract with an air carrier for the improvement of the air connectivity of Estonia as an SGEI, falling outside the framework of Regulation 1008/2008 and PSOs. As an SGEI, however, it would need to fulfil either the *Altmark* conditions, or the conditions of Article 106(2) TFEU, which require (for reasons of legal certainty) a tender to be held. As it would not fall within the PSO framework, tendering this SGEI would be subject to the general EU public procurement legislation.

One way to overcome competition issues is that the operation of the routes contained within the SGEI network should not be restricted exclusively to the tender winner.

It is indeed so that under the PSO legislation, as noted under above, bundling multiple routes under a single PSO is not permitted. This could be considered as an excessive restriction to the access of the routes as only air carriers with regional bases are likely to be able to provide services on all those routes.<sup>23</sup> This holds true for the bundling of PSOs because when they are tendered to a particular air carrier, this air carrier obtains the exclusive right to operate the PSO. Therefore, granting the exclusive right to operate multiple routes through a single PSO to a single air carrier would exclude other air carriers from operating some of the individual routes contained within that PSO which they could potentially have operated if each route was a separate PSO.

However, if one were to procure a network of routes as a SGEI falling outside the scope of PSOs, then the right to operate the routes within the network would not necessarily become an exclusive right of the tender winner. This way other air carriers would still be able to operate particular routes within the network of routes. Therefore, this model will not result in an excessive restriction to the access of the routes as would be the case when bundling PSOs.

As mentioned above, the SGEI to improve the air connectivity of Estonia will not fall within the scope of the legal framework regulating PSOs. Therefore the tender procedure prescribed under Article 17 of Regulation 1008/2008 would not be applicable. Instead the general EU tender rules would have to be followed in this case. The main legal documents under EU public procurement law are the following:

- Directive 2014/23/EU on the award of concession contracts;
- Directive 2014/24/EU on the procurement of public service contracts;
- Directive 2014/25/EU on the procurement by entities operating within specific sectors (including certain transport activities).

The award of a concession for the purpose of operating the network of routes would usually, due to the nature of concessions, require the exclusive right to operate the routes within the network for the air carrier(s) to which the concession has been awarded. Therefore it is important that the operation of the network would not be procured as a concession agreement. The central feature of a concession is the transfer to the concessionaire of an operating risk in exploiting those works or services encompassing demand or supply risk or both.<sup>24</sup> To avoid the contract constituting a concession agreement, it would be important that the risk of operating the network remains with the Member State.

Directive 2014/25/EU applies to activities relating to the provision or operation of networks which provide a service to the public in the field of transport by railway, automated systems, tramway, trolley bus, bus or cable. As regards transport services, a network shall be considered to

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<sup>23</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 26.

<sup>24</sup> Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28.3.2014, p.1, article 5(1).

exist where the service is provided under operating conditions laid down by a competent authority of a Member State, such as conditions as to the routes to be served, the capacity to be made available or the frequency of the service.<sup>25</sup> In addition it applies to activities relating to the exploitation of a geographical area for the purpose of the provision of airports and maritime or inland ports or other terminal facilities to carriers by air, sea or inland waterway.<sup>26</sup> However, no reference is made to activities comprising the provision of air transport.

Directive 2014/24/EU also does not make explicit reference to air transport services. However its scope is of a more general nature, applying to the acquisition by means of a public contract of works, supplies or services by one or more contracting authorities from economic operators chosen by those contracting authorities, whether or not the works, supplies or services are intended for a public purpose.<sup>27</sup> The transport services covered in Directive 2014/24/EU, and passenger transport services by rail or metro are explicitly excluded from its scope, but there is no further exclusion that would prevent the procurement of air transport services or the services related to the connectivity of a Member State or region from falling within the scope of this Directive.<sup>28</sup> Thus EU public procurement rules contained in Directive 2014/24/EU would, subject to meeting the thresholds under Article 4, be applicable for procuring an SGEI for improving the air connectivity of Estonia.

The application of EU public procurement legislation is also in line with the Commission's requirement that the bundling of routes should not excessively restrict the access to the routes. Not only because operating the routes would not be an exclusive right for the air carrier awarded the contract, as explained above, but also because the EU public procurement rules have the general aim of opening up markets to competition. Indeed, it is stated in the first paragraph of the preamble to Directive 2014/24/EU that *“for public contracts above a certain value, provisions should be drawn up coordinating national procurement procedures so as to ensure that [...] public procurement is opened up to competition”*.

It must be reiterated that the possibility to use this approach under EU law is still uncertain and untested. The Commission had originally intended that financing the operation of routes should be subject to the PSO legislation. It is therefore important to consult the Commission in order to discuss the use of this approach before it is implemented.

## **Promotion of the liberal air transport possibilities**

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<sup>25</sup> Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, OJ L, 28.3.2014, p. 243, article 11

<sup>26</sup> Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, OJ L, 28.3.2014, p. 243, article 12

<sup>27</sup> Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28.3.2014, p.1, article 1(2).

<sup>28</sup> Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28.3.2014, p.1, section 3.

One of the potential additional measures to improve connectivity could be promotion of a liberal air transport policy with countries outside of the EU to strengthen travel flows to Estonia, and via Tallinn to third countries within EU.

Air service agreements (“**ASA**”) are bilateral agreements between states which allow international commercial air transport services between their territories. On the basis of publicly available information, it has been established that Estonia currently has ASAs with the following non-EU countries: The People’s Republic of China, Russia, Armenia, Ukraine, Norway, and Singapore.

Generally it will also be specified within the ASA which particular air carriers will have air traffic rights between the two states. Based on the publicly available information it has not been possible to determine which air carriers have traffic rights in the above-mentioned agreements.

During the negotiations each party to the agreement will propose air carriers. It is not common for third countries in ASAs with EU Member States to accept that EU air carriers from Member States other than the Member State that is party to the ASA will have air traffic rights, unless the EU has negotiated a „Horizontal Agreement“ with that third country whereby the third country will accept any EU air carrier as having traffic rights. Therefore, when entering into ASAs with third countries it is likely that, in the absence of an EU horizontal agreement, the third country will only accept that an Estonian air carrier has air traffic rights.

In addition, as part of the EU’s external aviation policy the EU is actively entering into comprehensive air transport agreements with neighbouring third countries, and other specifically targeted third countries. With respect to the former, the European Common Aviation Area (“**ECAA**”) has been established. Under the comprehensive air transport agreements there are no limitations to the air traffic rights with respect to the origin or identity of air carriers.

Below is an overview of the comprehensive air transport agreements that have been signed, and those which are currently under negotiation. It should be noted that not all the comprehensive air transport agreements that have been signed are already in force.

**Table: Comprehensive air transport agreements**

Country	Signed	Under negotiation
Albania (ECAA)	X	
Australia		X
Azerbaijan		X
Bosnia and Herzegovina (ECAA)	X	
Brazil		X
Canada	X	
Croatia (ECAA)	X	
Georgia	X	



Iceland (ECAA)	X	
Israel	X	
Jordan	X	
Kosovo (ECAA)	X	
Lebanon		X
Moldova	X	
Montenegro (ECAA)	X	
Morocco	X	
New Zealand		X
Norway (ECAA)	X	
Serbia (ECAA)	X	
The former Yugoslav Republic of Macedonia (ECAA)	X	
The United States of America	X	
Tunisia		X
Ukraine		X

The overview of current and future comprehensive air transport agreements and ASAs must be taken into account when determining to what extent Estonia could and should expand their bilateral ASAs. By entering into additional ASAs Estonia can provide more connecting flights between EU Member States and various third countries. This way Estonia can strengthen its position as a transfer hub. Considering the geographical location of Estonia it can be observed that in particular third countries in the direction of Asia are interesting for this purpose.

The Russian Federation poses the greatest potential in terms of traffic flow, but is notoriously difficult in its ASA negotiations with others; for this reason we have sought to evaluate options to increase the market by liberalising the ASAs with other third countries but, in terms of geography, Russia and Belarus are the only significant beyond markets in range of the type of aircraft one would employ for the carrier foreseen. In view of the political discussions on maintaining economic sanctions against the Russian Federation, as well as the perception of the Russian external relations policy in the Baltic states, it is politically highly unlikely that any significant breakthrough in aviation relations will be achievable in the short- to mid-term.

#### Further Measures to stimulate market

The measures that are taken by various airports in Europe to stimulate additional services from airlines will normally be implemented either through a discount scheme of airport charges, or alternatively through individual airport services and marketing agreements between the airport and air carrier. They can be classified as follows:

##### 1. Airline Route Incentive Measures

Competition for airports to win new air services is intense. Airlines expect not only initial new route incentives but other forms of risk sharing and indeed longer term cost savings against official airport tariffs. The most common forms of incentives available are:

### 1.1. Typical Airport Aeronautical Charges

- Generally charges are made by airports *per aircraft landing* and / or departure (landing being the most common) on a per tonne basis.
- *Passenger charges* are levied per departing passenger and cover such costs as check in, terminal infrastructure, (potentially security costs too, though these are usually separate).
- *Handling fees* may apply at some airports, especially small ones, though are more commonly provided by third party suppliers. At airports which are self-handling, discounts may be offered on these fees.

### 1.2. Incentive Measures

#### a) Standard new route incentives

- For new routes, airports commonly offer discounts on landing charges and passenger fees on a regressive basis over a 3 to 5 year period
  - Marketing support may be offered too on a per passenger basis
  - This can be paid as a refund (to reimburse costs of airline marketing campaigns for example), or may be offered as a credit note on monthly fees

These rebates are widely used, and from an airline point of view are "nothing special" and regarded as relatively normal. They don't address long term cost levels for airlines at airports nor do they address the possible challenge of a second airline adding a new service on the same route

#### b) Route or Market Specific Discounts

- If an airport wishes to develop *specific* routes or markets, it can potentially offer reduced/differentiated charges *only* for those routes or markets which it wishes to see introduced. These would again be implemented via reduced landing and / or passenger charges on such routes/markets.

This provides increased flexibility and targeting but needs to be adjusted on a regular basis according to actual route development at an airport to make sure that the incentives remain in line with the airport's development strategy

#### c) Volume Deals

- Airlines are increasingly looking for *permanent* reduced charges compared to airport official tariffs and which extend beyond the short periods for which incentives apply.

- Airports are increasingly willing to offer bilateral and private discount deals for airlines willing to commit significant amounts of capacity, particularly when this capacity is provided by based aircraft and crews
  - Such schemes are based on *minimum* levels of departing annual passengers
  - They may include several tiers/thresholds of increasing discounts according to departing passenger volumes
  - Because such deals are private, there is more flexibility to structure them in the way which is most beneficial to each party, airport and airline
  - It is possible to include other elements such as stipulations about which routes are eligible and what times of day flights may be operated
  
- d) Capacity increase /traffic growth bonus/rebates
  - Traffic growth and/or frequency/capacity increases can be incentivised on specific routes by landing and/or passenger charge rebates or by paying per passenger marketing contributions
    - A base level against which increased traffic/capacity is measured needs to be established
    - Caution is required to ensure that such measures are not used in ways which could be seen as inequitable by being to the advantage of one airline but not to another
  
- e) Peak and Off Peak Pricing
  - Airports may wish to encourage use of infrastructure at quieter times of day or on quieter days of the week. Conversely there may be a desire to disincentivise increased activity at peak times.
  - This can be done by differential pricing with higher costs at peak times or lower costs at off peak times.

For some airlines, this may act as a strong incentive to grow or move capacity to times which suit the airport best in order to achieve cost savings. As such this can be a useful tool to manage infrastructure efficiently and to reduce the need for capital spending on new facilities or equipment.

On the other hand, for some airlines such measures may be perceived as limiting flexibility due to slot constraints at the other end of the routes, and for this reason they may not be effective.

- f) Seasonal Differentials
  - Incentive measures may be used to address traffic seasonality experienced by an airport
  - Lower charges may be offered in winter to encourage traffic growth and recognise greater risk to an airline of starting services in periods when demand is expected to be weaker.

- It may be possible, for example, to offer a zero landing charge and / or passenger fee for certain specified periods of the year
  - Such measures need to be reviewed regularly and adapted according to actual traffic development
- g) Risk Share /Revenue Underwrite
- To tackle airline concerns about financial risk or loss, some airports agree to underwrite (compensate) any actual losses experienced in operating a route, within agreed parameters
    - This can be more complex to manage as performance will vary from flight to flight and requires both an "open book" on financial performance by the operating airline and additionally takes a certain amount of administration.
  - An alternative approach may be guarantee a certain level of revenue on a route by purchasing a number of seats on a flight
    - Such arrangements need to have clear parameters and periods of operation to avoid simply subsidising a flight or route which will never work commercially

## 2. Regulatory Framework

Public airports in particular have to ensure that they respect regulations concerning non-discriminatory behaviour and the avoidance of State Aid to a particular airline. Such regulations apply to regional airports within the EU

A scheme will not constitute State aid when it has been demonstrated that it fulfils the MEO test. This requires an *ex ante* incremental profitability analysis to be undertaken. This is the standard test currently applied by the European Commission when assessing the financial relationship between an airport with public resources at its disposal and an air carrier under the EU State aid rules. Such an *ex ante* incremental profitability analysis involves calculating the difference between estimated incremental revenues and incremental costs generated by the scheme. A positive net present value indicates in principle that the measure in question has fulfilled the MEO test.

If a scheme fulfils the MEO test, any agreement between the airport and an air carrier that falls within this scheme will not constitute State aid. However, if the advantages under an agreement go beyond the scheme, this agreement will not necessarily be free of State aid.

Where an agreement is concluded between an airport and an air carrier that does not fall under the scheme, or where there is no such scheme, these agreements must be subject to a separate, individual *ex ante* incremental profitability analysis. This is the same test as is applied to a scheme, except now it is viewed in the context of an individual agreement. Thus, if the difference between the estimated incremental revenues and incremental costs stemming from a specific agreement result in a positive net present value, such an agreement will not constitute State aid.

In this context it is important to note that where airport service and airport marketing agreements have been concluded between the airport and air carrier, these will more than likely be assessed jointly. Therefore, the marketing fees paid to the air carrier should be taken in to the calculation

as an incremental cost. On the other hand, any increase to the number of passengers to be flown for the operating periods of the routes in question expected to arise from the marketing activities undertaken by the air carrier should be taken into consideration when calculating the incremental revenues. Private airports also need to be mindful of avoiding complaints or legal challenges, should they fail to apply any incentive measures used in a defensible and equitable manner

**3. Co-ordination of national initiatives**

There appears to be potential for a more coordinated pitch between the airport, the Chamber of Commerce, the Tourism sector and significant corporates who are prepared to commit to buy a certain amount of capacity on key strategic routes.

Convening all the parties around one table and offering the whole package could be an attractive and impressive proposition that could help TLL stand out from other airports either in a targeted pitch at Routes, Connect and other key fora.

Typical, publicly available examples of such schemes are:

<p><b><u>Timisoara:</u></b>          Provides services for full services and low-cost airlines</p> <p>The Marketing agreement determines the terms and conditions of the marketing activities to be carried to/by Wizzair advertising Timisoara as a destination with the aim to increase the number of departing and arriving passengers at the airport          The marketing agreement details the following marketing activities to be carried out by Wizzair:</p> <ul style="list-style-type: none"> <li>- The promotion of the Airport and Wizzair to/and from the Airport in its online and board magazine</li> <li>- Advertising of the airport on its website</li> <li>- Creation of a marketing strategy for the airport and Wizzair</li> <li>- Advertising promotions in relation to the air services on the Airport, and</li> <li>- Other activities promoting passenger growth at the airport</li> </ul> <p>Exact rebates are not published.</p>
<p><b><u>Larnaca</u></b>  <u>Incentive Schemes</u></p> <ol style="list-style-type: none"> <li>1. Marketing agreements              Up to €25 will be paid per departing passenger if the airline commits to establishing a base in Paphos or Larnaca and commits to a three year development plan including routes not currently served. In function of the total number of passengers, the incentive will be based on a scaled approach from €10 to €25 pax.</li> <li>2. Introduction of single new routes on existing routes operates by the airlines: Incentives range from €9 to €14 per departing passenger in function of number of weekly frequencies (1 to 7). They will scale down from €9 in 1<sup>st</sup> year to €7 in 3<sup>rd</sup> year and from €14 to 11 respectively.              Where applicable a cannibalization test will be conducted.</li> </ol>

3. €10 will be offered to airlines which increase passenger number on routes when Winter Seasons are compared.
4. Discount on landing fees for additional capacity: During the WS, a discount will be 100% in years 1, 2 and 3. In the SS, the discount will be 100% in year 1, 75% in years 2 and 50% in year 3.
5. A Bonus will be offered for contribution to net traffic growth; this bonus will be €1 per departing passenger for incremental traffic on existing routes.
  - a) Winter scheme for extending the season (an amount of €10 per incremental departing passenger will be offered to airlines that increase passenger number)
  - b) Discount on landing fees for introduction of additional capacity
  - c) Bonus on net traffic growth (tailored to reward airlines for their contribution to net growth on an existing route)
  - d) Marketing support (offered to airlines growing the number of services to the country)
6. Marketing support will be given based upon an agreement to grow the number of services and increasing passenger traffic. The objective is to share the airlines' risk in stimulating traffic in line with the airline development strategy. For additional services during at least 40 weeks, marketing support to finance activities and/or destination promotion to increase passenger traffic will be based upon a specific marketing plan in advance.

Any route which is subject to PSO as defined in Reg 1008/2008 will not qualify as an incentivized route under any of the schemes. If there is an overall reduction of seat capacity offered to Cyprus over 5% in a period of 12 months, payment of an incentive can be refused at any stage.

#### **Budapest**

Offers business development support for airlines to grow the number of services to new or existing destinations and increasing passenger traffic. Business development will be provided to airlines planning to launch new services or increase frequency of existing services

- **Landing charges** - All new routes may be eligible for reduction of landing fees. Criteria of all incentives are:  
 At least 2 weekly flights – year around operation – retroactive crediting – new route: not operated by any other airline 1 year before launch
  - 5 year incentive for airlines new long haul routes; landing charges discount
  - 5 year incentive for airlines operating new short haul route; landing charges discount
  - 2 year incentive for airlines starting new seasonal flights
  - 1 year incentive scheme for additional flights on existing international routes
- **Passenger service charges incentives** - in order to support new markets, Budapest airport offers the new thin route incentive. New routes operated btw 2 and 4 frequencies per week receive discount of 50% of the passenger service charge during the first 3 years of operation
- **Operational incentives** (Traffic increase incentive, seat load factor incentive, Turnaround productivity incentive)

#### **Vilnius**

- **New route incentive**  
 Any airlines that establishes a new route from VNO may benefit from a discount on airport charges for services provided for that new route, in accordance with a set of criteria:
  - The discount may be applied to the following airport charges:

<p>Departing passenger charge – Aircraft landing charge – Aircraft parking charge</p> <p>➤ <b>Level of route support:</b> discount on airport charges shall be applicable for routes operated on a year round basis and seasonal routes</p>
<p>Italian Guidelines for incentive schemes</p> <p>On 19 September, the Italian Guidelines were made the subject of a verbal enquiry by an MEP. In her response on 25 November, Commissioner Vestager (E-006945-16) pointed out that all aids granted on the base of the national guidelines must be notified to the Commission; but the Commission had not been notified, and the national guidelines explain the EU Guidelines without imposing an obligation to actually grant state aids. The Directive 2014/23 EU sets out the principles under which concession contracts may be awarded, but does not specify what the concessionaire does with the revenues.</p>
<p><b>Riga</b></p> <p>The Incentive Scheme distinguishes between new routes and passenger growth.</p> <p><b>New routes</b></p> <p>For flights up to 3500 km, aircraft parking is free of charge for first hour; the passenger charge is €0.31 in 1<sup>st</sup> year, €1.25 in 2<sup>nd</sup> year and €2.19 in third year.</p> <p>For flights over 3500 KM, there is no passenger charge in 1<sup>st</sup> year, €0.94 in 2<sup>nd</sup> year, and €1.55 in third year.</p> <p><b>Passenger growth</b></p> <p>The passenger charge is reduced from €3.10 to €1.55 for each outgoing passenger in y-to-y comparison in case of passenger growth.</p>
<p><b>Ljubljana</b></p> <p>The airport was sold to Fraport in 2015. Fraport abolished volume based rebates (which had the effect of undermining Adria’s growth plan out of its hub), and focused on marketing LJU as a destination for inbound tourism through all of its channels. It did not want to lose the national carrier Adria, but was prepared to accept its market exit, if other carriers met the demand previously served by Adria on its routes.<sup>29</sup></p> <p>An own incentive scheme cannot be found on LJU website or in other sources.</p>
<p><b>Malta</b></p> <p><b>New Routes:</b> If the service has been terminated by an airline, it is deemed a new route only after 24 months of non-service. Airports within 150kms are not eligible, unless considered of strategic relevance. During summer at least 2/7, during winter 2/7 at least. If an airline is already benefitting from an incentive agreement with the Malta Tourism Authority (MTA), the incentive shall be paid to the MTA and not to the carrier.</p> <p><b>Rebate in summer:</b> 30% less than the published €4.75 in 1st year; 20% less than the published €3.17 in 2nd year; 10% less than the €1.58 in 3rd year.</p> <p><b>Rebate in winter:</b> 40% less than the €6.34 per departing passenger in 1st year; 30% less than €4.75 in 2nd year; 20% less than €3.17 in 3rd year.</p> <p>1. Strategic Routes</p> <p>Rebates are higher to Finland, Baltic States, Russia (excl. MOW), Eastern Europe, France (Nantes, Nice), Switzerland (excl. ZRH), Portugal, Germany (Leipzig, Dresden).</p>

<sup>29</sup> Source: Fraport SVP International Acquisitions

<p>The rebates in Summer Flight Period are for 1<sup>st</sup> year: €6.34 – 40%  2<sup>nd</sup> year: €4.75 – 30%  3<sup>rd</sup> year: €3.17 – 20%</p> <p>In WS for 1<sup>st</sup> year: €9.50 – 60%  2<sup>nd</sup> year: €7.92 – 50%  3<sup>rd</sup> year: €6.34 – 40%</p> <p>3. Transfer: Malta International Airport refunds €8 per departing transfer pax</p> <p>4. Free Landing in Winter: 100% refund of landing fees refunded</p> <p>5. €4 per departing passenger to any non-EU destination will be refunded during winter and summer season.</p> <p>6. For scheduled passenger flights night-stopping in Malta, 100% of charges will be refunded in winter and summer.</p> <p>7. Night surcharges (night is defined as from 20.00 – 5.00 local time and 19.00 – 6.00 respectively) will be refunded.</p>
<p><b>Hamburg</b></p> <p>The airport offers, under highly restrictive conditions, rebates for new routes (Intercontinental degressing from 100% to 75% to 50% in years 1, 2 and 3 respectively; for intracontinental routes a two year plan is foreseen consisting of a 75% in year 1 and a rebate of 50% in year 2. The support provided must not exceed 50% of the airline's investment costs for the new connection, as defined by the Charleroi ruling of 12.02.2004.<sup>30</sup></p> <p>A route growth incentive programme is also offered as an alternative; it is not possible to benefit from both programmes.</p> <p>The Publication lists all of the charges of the airport, including PRM and Security charges.</p>
<p><b>Vienna</b></p> <p>Transfer Incentive of €12, 50 applies if the total growth of local passengers at VIE is at least 3% than the previous year. Depending on the number of transfer passenger growth, the incentive amount varies from the base amount to €13, 80 for 10% growth.</p> <p>Destination Incentive. For new destinations intercontinentally, the landing fee will be reduced by 100%, 80%, 60% and 40% in years 1-4; for all flights in Europe, the landing fee will be reduced by 80%, 60, and 40% in years 1-3. This scheme thus distinguishes duration of the scheme for intercont and cont flights.</p> <ol style="list-style-type: none"> <li>1. Additional frequency incentive: a refund of 60%, 40% will be granted on landing fees for all additional frequencies to the same destination in years 1 and 2 to Eastern Europe and intercontinental.</li> <li>2. High Frequency Incentive: Landing fees for flights to Eastern Europe will be refunded by 20% as of 7/7, 20% as of 10/7, 30% as of 14/7, 40% as of 21/7, and 50% as 28/7. Landing fees for intercontinental flights ex VIE will likewise be refunded if frequencies are increased in a range between 3/7 to 28/7.</li> <li>3. Growth incentive for point-to-point services: this Incentive is not quantified and subject to several conditions and negotiations with the carrier.</li> </ol>
<p><b>Prague</b></p>

<sup>30</sup> This caveat was not to be found in any other incentive scheme of other airports. The airline must therefore provide documentary evidence of the costs and expected traffic for the new connection. The process for so doing will be defined and agreed on a case-by-case basis.



The airport has published the types of incentives, (route-based, volume-based and additional incentives, such as reductions on transfer taxes, use of mobile resources incentive, and „non-residential incentive“, but not provided for clarification on conditions and level of the incentives. These could be subject to negotiations.

#### **4. Regulatory framework**

If a body invested with a general interest task to develop a region, such as a regional authority, tourism authority, or chamber of commerce, was to enter into a marketing agreement with an air carrier, the first question to be asked is whether this body also has a link to the airport or the airport operator. Should this be the case, most likely the incremental analysis described above will apply. Should this not be the case (i.e., no connection between the body and the airport operator), an alternative test will apply.

Under this alternative test it must be demonstrated that the services meet the actual needs of the public purchaser, and that the services were purchased at a price equal or below the market price. In particular concerning the requirement that the agreement meets the actual need of the public purchaser, regarding marketing agreements the Commission has noted that it cannot target the commercial activities of a clearly defined undertaking, such as an airport or air carrier. Therefore marketing activities should be targeted at promoting the region in general.

Regarding the market price, the Commission has noted that there are no clear benchmarks for marketing services. Therefore the Commission will usually expect a public tender to be held, or at least that several providers are consulted, and their offers are compared.

#### **Scenario analysis**

A scenario analysis was not required by the tender. We submit, however, that this may prove to be a useful tool to evaluate the options, given the commercial/financial and legal risks for the government to openly support further routes to/from Tallinn despite the existence of a functioning, albeit thin market, and in the absence of safe legal grounds (as elaborated below) that group PSOs would be compliant with the EU provisions.

It is worthwhile considering a scenario, in which, for whatever reason, Estonia's national airline fails to succeed commercially and either folds, or is 100% acquired by, for example LOT. In such a scenario, which would require further analysis, the absence of a national airline owned by the government would limit the government's ability to influence the degree to which connectivity is provided to Estonia throughout the year; any PSO would be tantamount to having the taxpayer pay for a non-national airline to operate services, although indirect options exist to reach the final destination, and would be paid for by the passengers.

A further scenario with far-reaching but different implications, is one in which the national airline co-operates with another airline to serve destinations from Tallinn directly and indirectly via the hub of the partner airline but using the operator's code. Such a co-operation could take the form of a mere code-share agreement, or of a closer co-operation requiring a solid business model and approval by DG COMP.

## 9. Legal framework for measures to enhance connectivity within the EU

Conceptually, it is possible to make a distinction between:

- the rules covering situations where a Member State acts as a customer; and
- Rules governing actions of a Member State where it is acting as an entrepreneur.

The two alternatives represent a difference in the nature of the public funding by a Member State. Where the State acts as a customer, it will purchase certain services whereby public policy considerations come into play. For instance, the State may remunerate an air carrier to operate a certain amount of flights on a particular route for the purpose of improving the connectivity of a particular region. Where the State acts as an entrepreneur, only economic considerations would be taken into account. The State will then look at the conditions to be accepted as an entrepreneur under EU law, and subsequently also at the other possibilities which exist under the EU legal framework for an entrepreneur to receive public funding.

In this section we will provide first an overview which will cover PSOs and SGEIs, which are important tools for a Member State when acting as a customer.

Secondly, we will provide an overview of the relevant EU framework when the State acts as an entrepreneur. This will cover the conditions for the market economy operator test which is necessary to be passed in order for the Commission to accept that the State acted as an entrepreneur investing in an air carrier and respectively in an airport. It will then continue looking at the different justifications for State aid to be held compatible with the internal market.

### **The State Acting as a Customer**

#### *1. PSO*

Regulation 1008/2008 sets out, in Articles 16 to 18, the specific rules related to PSO for air services. An "air service" entails a flight or series of flights carrying passengers, cargo, or mail for remuneration or hire. It is important to note that with relation to air transport services, PSO can

exclusively be imposed in accordance with this regulation.<sup>31</sup> It sets out very detailed procedure for setting up the PSO and for compulsory tendering.

*i. Requirements for imposing a PSO on a given route*

PSO have been addressed under the following EU legal instruments:

- Regulation 1008/2008 which sets out the rules for establishing a PSO under Articles 16 to 18.
- In the Aviation Guidelines the SGEIs are discussed in Section 4. Under this section, the definition of PSO is also briefly discussed (see Section 4.1).
- The Commission is currently in the process of drafting guidelines in order to assist Member States and stakeholders with the application of the PSO legislation (“**draft Guidelines for PSO**”). We had access to these draft guidelines. They were circulated to stakeholders to provide comments between June and September 2016. It is important to note that they do not constitute the final version. As stakeholders have submitted their views, there will likely be changes before the Commission publishes the final version. However, they have nonetheless been used as they provide a valuable insight to the thinking of the Commission.

The draft Guidelines for PSO provide some further guidance with respect to some of the terminology used in Article 16.<sup>32</sup>

- A peripheral region is a remote region or a region which is difficult to access from the capital and other main cities in the country. This must be assessed, taking into consideration the territory, and the administrative, business, education, and medical centres of the Member State concerned, and any Member State with which it shares a border.
- A development region is one that is lagging behind from an economic perspective. The draft Guidelines for PSO note that a region where GDP per inhabitant is lower than 75% of the EU average would normally fall under this term.
- Finally, there has been no concrete quantification as to what will constitute a thin route. However, based on experience it is unlikely that a route with traffic of more than 100 000 passengers per year will fall within this term.

In addition, in accordance with Article 16(1) of the regulation, the PSO will only be imposed to the extent that is necessary to ensure the minimum services required to ensure the standards set by the Member State regarding continuity, regularity, pricing, or minimum capacity that an air carrier would not provide if they were only considering their commercial interests.

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<sup>31</sup> Guidelines on State aid to airports and airlines, paragraph 70.

<sup>32</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 18.

As Stated under Article 16(3) of the regulation, necessity and adequacy of the PSO shall be assessed on the basis of: the proportionality of the obligation and the economic development needs of the region; the possibility of relying on alternative modes of transport, and the ability of these alternative modes to meet the transport needs of the Member State; the air fares and conditions which can be quoted to users; and the combined effect of all air carriers operating or intending to operate on the route. Regarding the alternative modes of transport, it is of particular relevance where there is an existing rail service operating the envisaged route with a travel time of less than three hours, and with adequate frequencies and satisfactory timings.

Article 16(2) of the regulation provides that were other forms of transport are not capable of providing an uninterrupted service with a minimum of two daily frequencies, a Member State may require an EU air carrier intending to operate the route to guarantee that it will do so for a certain period of time.

The procedural steps to be followed in order to impose a PSO are covered in Article 16(4) to 16(6) of Regulation 1008/2008. First, the Member State must communicate the envisaged PSO to the Commission, the Member State(s) concerned, the relevant airports, and any air carrier operating the route in question. Subsequently and information notice will be published by the Commission in the Official Journal of the European Union (“OJEU”). The information notice will mention, among others, the date of entry into force of the PSO. Where the route is expected to be used by fewer than 10 000 passengers per year the information notice may also be published in the national official journal of the Member State concerned.

In addition, under Article 18 of Regulation 1008/2008 Member States must take all necessary measures to ensure that any decision taken under Articles 16 and 17 can be reviewed effectively.

The Aviation Guidelines make reference to the concept of a “group of routes”. This likely means a sequence of routes in a single journey of connected flights, as it is provided under footnote 76 of the Aviation Guidelines that both the origin and destination airports must be clearly identified. PSO may in general apply to routes with one or more stopovers. However, the assessment of the adequacy of the PSO needs to be made for each flight segment individually. The PSO should not apply to flight segments which do not qualify for it.<sup>33</sup>

With regard to the possibility of bundling routes as a PSO, the draft Guidelines on PSO suggest that it is not possible under Regulation 1008/2008 to bundle different routes in such a manner as to make the access to one particular route dependent upon the service of other routes.<sup>34</sup> Therefore under the framework for PSO the criteria must be assessed for each route individually. It should be noted that the PSO rules on bundling routes seem to be incompatible with the possibility to procure air transport networks under the general EU public procurement legislation.

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<sup>33</sup> For example, if PSO is imposed on the route A to C via B, then the eligibility of the routes A–C, A–B and B–C should be assessed individually. If, for example, the route B–C would not qualify for PSO on its own, then no obligations should apply to air carriers carrying passengers and/or cargo from B to C. The obligations on the route A–C should not hamper the free provision of air services on the route B–C.

<sup>34</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 26.

The possibility for multiple PSO routes to be tendered under a single tender is provided for in Article 16(10) of Regulation 1008/2008, which provides the following: “*The right to operate the services referred to in paragraph 9 shall be offered by public tender in accordance with Article 17, either singly or, in cases where justified for reasons of operational efficiency, for a group of such routes to any Community air carrier entitled to operate such air services. For reasons of administrative efficiency, a Member State may issue a single invitation to tender covering different routes.*”

The draft Guidelines on PSO provide further guidance on this, stating in section 5.6. That:

*“In principle, Member States should proceed to public tenders for each individual route. However, the Regulation allows Member States to issue a public tender for a group of PSO routes, but only where justified for reasons of operational efficiency. In practice this means granting exclusivity to one carrier for a group of PSO routes.*

*Such grouping of routes is allowed in particular where several routes with thin traffic present important operational complementarities (e.g. routes to/within an isolated archipelago or remote and densely populated area).*

*The reasons for grouping have to be of an operational nature (e.g. necessity of an operational base in a remote area) and may not have as main objective to reduce the budgetary impact on the Member State. In this sense, the grouping of profitable and unprofitable routes without operational commonalities is not possible.”*

#### *ii. The possibility of establishing international PSO*

A distinction must be made between international and intra-EU routes.

Regarding intra-EU routes, although it seems from the wording of Article 16(1) of Regulation 1008/2008, that it is possible to establish intra-EU PSO, this seems to be very limited in practice. At the end of 2015, out of a total of 173 PSO routes in Europe, only five did not constitute domestic routes. Of the five, four related to access to European institutions and one was more related to a unique historical/linguistic/cultural relationship which offers no precedent for Estonia. These included the following routes:<sup>35</sup>

- Larnaca (Cyprus) – Brussels (Belgium)
- Mariehamn/Åland (Finland) – Stockholm (Sweden)
- Strasbourg (France) – Amsterdam (The Netherlands)
- Strasbourg (France) – Madrid (Spain)
- Strasbourg (France) – Prague (The Czech Republic)

Regarding international routes, which link an EU Member State to a non-EU State, it is not possible to impose PSO on these routes under the current legal framework.

#### *iii. Operating a PSO route*

As provided under Article 19(9) of Regulation 1008/2008, only EU air carriers (*i.e.* those holding a valid operating license issued by the competent authorities of a Member State or certain third country States) can operate PSO. Once the PSO has entered into force, the EU air carrier already

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<sup>35</sup> None of these PSOs are still in force to date.

operating the route may offer seat-only sales, as long as the service they provide fulfils the obligations under the PSO. Additionally, any EU air carrier can start operating this route, also provided that the obligations under the PSO are adhered to.

If there is no EU air carrier operating the route, or can demonstrate that it will start operating the route in accordance with the PSO, the Member State may grant a single EU air carrier the exclusive right to operate the route for a period of four or five (for outermost regions) years, after which there will be a review of the situation. The Member State must grant this exclusive right through a public tender, as set out in Article 17 of the Regulation.

First, the Member State must communicate the entire text of the invitation to tender to the European Commission. This is not necessary where the PSO has previously been published in the State's national official journal. Then the tender shall also be published in the national official journal. The invitation to tender must contain certain points, including the standards required by the PSO, the period of validity of the contract, and objective and transparent parameters on the basis of which the compensation for the discharging of the PSO shall be calculated.<sup>36</sup>

The Commission will subsequently make the invitation to tender known through an information notice published in the OJEU.

The selection among the submissions shall be made by the Member State taking into account:

- The adequacy of the service (including the prices and conditions which can be quoted to users);
- The cost of the compensation required from the Member State.

Member States enjoy a degree of discretion when setting out the weighing principles for the purpose of making this selection. Also, Member States are entitled to set a cap, limiting the maximum of compensation that can be paid.

The compensation to the air carrier for adhering to the standards required by the PSO may not exceed the amount required to cover the net costs incurred in discharging each PSO. This assessment shall take the revenue produced by the air carrier and a reasonable profit into account.

Once the selection has been made, the Member State must inform the Commission of the outcome of the tender, including the following information:

- Numbers, names and corporate information of the tenderers;
- Operational elements contained in the offers;
- Compensation requested in the offers;
- Name of the selected tenderer.

The commission may furthermore request from the Member State all relevant documentation related to the selection of an EU air carrier.

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<sup>36</sup> See Article 17(2) of Regulation 1008/2008 for a complete overview of the mandatory points to be included in the invitation to tender.

### *in. PSO and State aid*

It is important to note that compliance with the rules on PSO set out in Articles 16 to 18 of Regulation 1008/2008 does not remove the necessity for Member States to assess the compliance with the State aid rules under Article 107 TFEU.<sup>37</sup> Thus the State aid assessment takes place separately from the assessment of the PSO legislation.

Where there is no public service compensation provided by the Member State and an air carrier is operating the route in accordance with the PSO of its own accord, then there are no Member State resources involved and thus also no State aid.

However, when public service compensation is provided by the Member State it will be necessary for the Member State to award this compensation in accordance with the *Altmark* criteria in order to avoid falling within the scope of European State aid law. The *Altmark* criteria will be discussed further below. Although the PSO rules in Regulation 1008/2008 do integrate the *Altmark* criteria, compliance with the PSO rules does not automatically mean compliance with the State aid rules.<sup>38</sup>

Where these criteria have been met, the public service compensation will not constitute State aid, and therefore notification of the measure under Article 108(3) TFEU is not necessary. However, when the *Altmark* criteria have not been met, the public service compensation will confer an advantage on the air carrier benefitting from it, and thus may constitute State aid, subject to the fulfilment of the remaining elements of State aid under Article 107(1) TFEU.<sup>39</sup>

When public service compensation does constitute State aid, the aid can be regarded as compatible with the internal market when it meets all the compatibility criteria under Article 106(2) TFEU. The application of Article 106(2) TFEU will be discussed further below.

## **2. SGEI**

For the purpose of EU law, an SGEI can be viewed in the light of case law of the CJEU in the *Altmark Trans* ruling,<sup>40</sup> and also in the light of Article 106(2) TFEU.

- Under the former case the consideration granted for the performance of the SGEI will not constitute State aid if the criteria provided by the *Altmark* case have not been met.
- Under the latter case, public service compensation which fulfils the conditions of an SGEI under Article 106(2) TFEU *does* constitute State aid, but will be considered to be compatible with the internal market and thus permitted.

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<sup>37</sup> Guidelines on State aid to airports and airlines, paragraph 71.

<sup>38</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 98.

<sup>39</sup> Guidelines on State aid to airports and airlines, paragraph 74.

<sup>40</sup> Judgment of 24 July 2003, *Altmark Trans* and *Regierungspräsidium Magdeburg* C-280/00, EU:C:2003:415.

An SGEI must have special characteristics compared to a regular economic activity. The general interest objective must go beyond simply developing certain economic activities or areas, which would be covered under Article 107(3) TFEU.<sup>41</sup> Generally Member States will have a wide margin of discretion to determine which services constitute an SGEI, except where the EU has set out rules defining the scope of the existence of an SGEI.

*i. Altmark Trans*

In its *Altmark Trans* ruling in 2003 the CJEU set out the basic rules for when public compensation payments for the operation of a PSO do not constitute State aid under European law.

State aid will be discussed in more detail below, however for the purpose of SGEIs it is necessary to already understand that under Article 107(1) TFEU, which contains the definition of State aid, there are multiple elements that must be present for a measure to constitute State aid. One of these elements requires the measure to confer an advantage on the undertaking concerned. In basic terms this entails that the undertaking attains a benefit that it would not have under normal market circumstances. The *Altmark Trans* case sets out the conditions under which there is no advantage conferred upon the undertaking concerned, and thus no State aid.

In its judgment, Court set out the following criteria:

- 1) The recipient undertaking must actually have a PSO to discharge, and the obligations must be clearly defined.
- 2) The parameters on the basis of which the compensation is calculated must be established in advance, in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings.
- 3) The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of PSO, taking into account the relevant receipts and a reasonable profit for discharging those obligations.
- 4) Where the undertaking which is to discharge PSO, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tendered capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

A PSO for air transport services can only be established in accordance with Regulation 1008/2008.

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<sup>41</sup> Under Article 107(3) TFEU measures that constitute State aid under Article 107(1) TFEU can be held compatible with the internal market.



Regarding the criterion that the parameters must be established in advance, it is not necessary that the exact amount of compensation is set out in advance. It is merely necessary that it is clear from the beginning how the compensation will be determined. The authorities have some room for manoeuvre when setting out the parameters. It is for this reason that the parameters must be objective and transparent, as this will permit the Commission and any competitors to verify the absence of any abusive use of the concept of an SGEI.

A “reasonable profit” as required under the third criterion means the rate of return on capital that a typical company that is considering whether or not to provide the SGEI would require. Where possible, this should be determined through a benchmarking exercise by looking at similar types of public service contracts.<sup>42</sup> If necessary this reference can be to public service contracts in other Member States or other sectors. However in practice it has been seen that the Commission will not be easily convinced by a benchmark.

With respect to the use of a public procurement procedure in the context of the fourth *Altmark* condition, it must be determined which procedure to use. The EU has enacted various public procurement Directives covering public service contracts and concession contracts. No matter what procedure is used, it is essential to ensure that the service is provided at “the least cost to the community”.

The public procedure to be used for a PSO related to air transport services must be in accordance with Article 17 of Regulation 1008/2008 which requires an open call for tender, as explained above. The majority of the contracts awarded under this procedure constitute service concessions.<sup>43</sup> Directive 2014/23/EU,<sup>44</sup> which normally applies to public concession agreements, under Article 10(3) explicitly excludes its application to concessions for air transport services. Therefore Article 17 of Regulation 1008/2008 shall apply exclusively to the award such concession agreements.

Under a concession agreement, the operator bears the operating risks related to the demand for his transport services. If the operator does not bear his own risk, then the contract constitutes a public services contract, which is covered by Directives 2014/24/EU<sup>45</sup> and 2014/25/EU.<sup>46</sup> Unlike Directive 2014/23/EU, these two directives do not contain an exclusion for air transport services. Thus, when an agreement for the purpose of operating the PSO constitutes a public service agreement, Article 17 of Regulation 1008/2008 will apply simultaneously to the two EU public procurement Directives.<sup>47</sup>

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<sup>42</sup> Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJEU C 8, 11.1.2012, p. 4-14, paragraph 61.

<sup>43</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 117.

<sup>44</sup> Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28.3.2014, p.1.

<sup>45</sup> Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, OJ L 94, 28.3.2014, p.65.

<sup>46</sup> Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, OJ L, 28.3.2014, p. 243

<sup>47</sup> Draft Commission guidelines on the application of PSOs for air routes, paragraph 117.

In addition to air transport services, the Commission considers with respect to airports that in some cases the overall management of an airport can constitute a SGEI.<sup>48</sup> This is limited to situations where part of the area potentially served by the airport would be isolated from the rest of the Union to an extent that would harm its social and economic development without the airport. A SGEI can then be imposed to ensure that the airport remains open to commercial traffic. This should not, however, include the development of commercial air transport services by the airport.

*ii. Article 106(2) TFEU*

Public service compensation which fulfils the conditions of an SGEI under Article 106(2) TFEU does constitute State aid, but will be considered to be compatible with the internal market and thus permitted.

Article 106(2) TFEU provides that: “Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union”. This provision has been given further shape through case law, Commission practice, and secondary EU legislation.

There are two ways in which the funding of an SGEI under Article 106(2) TFEU can be held to be compatible with the internal market:

- First, a measure may be permitted without the obligation to notify it to the Commission (Commission Decision 2012/21/EU).
- Second, a measure may need to be notified to the Commission (SGEI framework).

Commission Decision 2012/21/EU<sup>49</sup> lays down the conditions under which certain types of public service compensation are to be regarded as compatible with the internal market and which are exempt from the notification requirement under Article 108(3) TFEU. The public service compensation falling under the scope of this decision is exempted from the notification requirement because the decision covers specific, standardised cases which fall under Article 106(2) TFEU. In the field of aviation, the scope of Decision 2012/21/EU is limited to:

- compensation for the provision of SGEIs as regards air (or maritime) links to islands on which the average annual traffic during the two financial years preceding that in which the SGEI was assigned does not exceed 300 000 passengers;
- compensation for the provision of SGEIs as regards airports for which the average annual traffic during the two financial years preceding that in which the SGEI was assigned does not exceed 200 000 passengers.

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<sup>48</sup> Guidelines on State aid to airports and airlines, paragraph 72.

<sup>49</sup> Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (notified under document C(2011) 9380), OJEU L 7, 11.1.2012, p. 3-10.

The SGEI framework<sup>50</sup> applies to aid in the form of public service compensation which does not fall within the scope of Decision 2012/21/EU. It therefore constitutes the basis for assessing the compatibility of State aid granted to finance an SGEI. Contrary to Decision 2012/21/EU, under the SGEI framework the notification requirement under Article 108(3) TFEU does apply.

If it is known, or there is a suspicion that the *Altmark* test has not been passed, and Decision 2012/21/EU does not apply, then the measure should be notified to the Commission. The Commission will then look into the conditions provided for in the SGEI framework.

## **The State Acting as an Entrepreneur**

This Section will address the EU legal framework where the State is acting as an entrepreneur.

First, the conditions to be accepted as an entrepreneur under EU law will be looked at. This encompasses the conditions for the market economy operator test (“**MEO test**”) which must be passed in order for the Commission to accept that the State has acted as an entrepreneur investing in an air carrier and/or in an airport.

In some cases, an entrepreneur may also resort to public funding, and therefore the EU legal framework for an entrepreneur receiving public funding will also be looked at. This encompasses the different justifications for State aid to be held compatible with the internal market such as aid for the development of certain economic activities or areas, or aid falling under the General Block Exemption Regulation.

### *1. General Considerations on the MEO test*

As a preliminary remark, it must be noted that under this section past investments by the Estonian government will not be analysed. Instead this section will provide the general principles of the market economy operator principle, and how it can be applied in the future.

For a measure to constitute State aid as defined under Article 107(1) TFEU, the following conditions must be met: (1) the measure in question is financed through State resources and is imputable to the State; (2) the measure confers an economic advantage; (3) the advantage conferred is selective; (4) the measure in question distorts or threatens to distort competition and may affect trade between Member States. These conditions above are cumulative in nature, meaning that all must be fulfilled for a measure to be caught by the EU State aid rules. This also means when it can be shown that one of the above criteria has not been fulfilled, the measure at hand will not be caught by Article 107(1) TFEU.

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<sup>50</sup> Communication from the Commission on a European Union framework for State aid in the form of public service compensation (2011), OJEU C 8, 11.1.2012, p. 15-22.

This section will focus on criterion two listed above: “the measure confers an economic advantage”. To determine whether an advantage has been granted one must apply the MEO test. Under the MEO test the behaviour of public bodies is compared to that of similar private economic operators under normal market conditions.

When applying the MEO test, only the benefits and obligations linked to the role of the State as an economic operator should be taken into account. Therefore, any public policy considerations that a State may have are to be disregarded. Furthermore, the test is applied from an ex ante point of view, having regard to the information that was available at the time the intervention was decided on.

When the State is investing in an undertaking, its conduct should be compared to that of a similar private economic investor under normal market conditions. For this purpose it is important to note that EU law does not distinguish between public and private ownership.

It is necessary to determine, also from an ex ante point of view, what the expected rate of return from the investment is. The general idea here is that a private investor would be reluctant to make a loss from the investment in the long run. Therefore the CJEU has held that the investor to which the State must be compared must be a prudent and informed market investor.

Since the assessment must take place from an ex ante point of view, an ex poste finding that that an investment made by the state was actually profitable will not suffice.

*i. Compliance with market conditions under specific circumstances*

When establishing whether a public body acted in compliance with market conditions under the MEO test, it is possible to identify the following specific situations:

- Situations where market conditions can be directly established based on market data specific to the transaction.
- Situations where there is no transaction-specific data, and thus where one must resort to alternative available methods (such as benchmarking).

Under the first situation, where the market conditions can be directly established, one can distinguish between two further situations, namely:

- Where the transaction is carried out *pari passu* (on an equal footing) by public entities and private operators. Under this situation the following conditions should, in particular, be assessed:
  - Whether the intervention of the public entity and private operators has taken place at the same time.

- Whether the terms and conditions of the transaction are the same for both the public bodies and all private operators involved, also taking into account the possibility of increasing or decreasing the level of risk over time.
  - Whether the intervention of the private operators has real economic significance and is not simply symbolic or marginal.
  - Whether the starting position of the public bodies and the private operators involved is comparable with regard to the transaction.
- The sale and purchase of assets, goods and services through competitive, transparent, non-discriminatory and unconditional tenders. When a tender complies with these conditions, and is in line with the EU principles on public procurement, then it can be presumed that the transaction can be considered to be in line with market conditions. It is important to note, however, that this does not hold true where a State provides public support through a tender fulfilling these conditions for public policy reasons.

Under the second situation, where there is no transaction-specific data, it can be established that a transaction is in compliance with market conditions by looking at terms under comparable situations carried out by comparable private operators under comparable situations through a benchmarking exercise. A benchmark cannot be conducted where regard has not been had to market considerations, or the existing prices are distorted by public interventions.

## *2. The MEO test as applied to air carriers under the Aviation Guidelines*

This section will cover two different situations, first the situation where a State invests directly into an airline, and secondly when provides funding to an airline through an airport.

When a State invests directly in an airline, the following criteria are relevant when determining the expected normal rate of return: the financial performance of the airline, the economic and technical efficiency of the airline, and the commercial strategies for different markets.

A State can also provide funding to airlines using a publicly owned airport.

The Aviation Guidelines describe how the relationship between an airport with financial resources at its disposal and an airline should be looked at. This situation may arise when a Member State opts to stimulate flights by using an airport. State aid to an airline through an airport can be disregarded where the relationship is in conformity with the MEO test.

As has been explained above, the Aviation Guidelines provide guidance on the application of the MEO test when addressing the financial relationship between airports and air carriers where an airport has public resources at its disposal.

There are two ways to establish that an airport has acted in accordance with the MEO test, namely:

- a. when the price charged for the airport services corresponds to the market price; or
- b. when it can be demonstrated through an *ex ante* analysis that the arrangement between the airport and air carrier will lead to a positive incremental profit contribution for the airport.

The Aviation Guidelines hold that, at the time they were drafted, the former approach was not considered to be suitable because it was not deemed possible to identify an appropriate benchmark to establish a true market price for services provided by airports. The Aviation Guidelines do allow room for this situation to evolve in the future. However, to date the Commission has not accepted this approach, as will be seen in the overview of Commission Decisions presented below.

Therefore the relevant approach for applying the MEO test to airport service and airport marketing agreements is an *ex ante* incremental profitability analysis. The airport should demonstrate that it is capable of covering all costs stemming from the arrangement, over the duration of the arrangement, with a reasonable profit margin, on the basis of sound medium-term prospects.<sup>51</sup> For this purpose the following must be taken into account:

- The expected non-aeronautical revenues stemming from the air carrier's activity, together with airport charges, net of any rebates, marketing support, or incentive schemes. In this context the Commission will consider the expected number of passengers to be flown by the airline for the operating periods of the routes.
- All expected costs incrementally incurred by the airport in relation to the air carrier's activity at the airport. This could include, for instance, incremental personnel, equipment and investment costs induced by the presence of the air carrier at the airport.

When the balance between the expected incremental revenues and expected incremental costs results in a positive net present value, this will, in principle, indicate that the measure has fulfilled the MEO test, and thus does not constitute State aid.

### *3. The MEO test applied to airports under the Aviation Guidelines*

Public financing of airports should be assessed on the basis of the MEO test on the granting authority. The profitability of an airport must take into account airport revenues. This should include airport charges such as runway charges, passenger charges, terminal navigation or aeroplane parking, and also non-aeronautical revenues such as car parking, car rental, restaurants, and other retail, or property and real estate income. Airport investments can lead to higher aircraft and passenger traffic, and this higher (non-)aeronautical revenues. Any traffic forecast should, however, be realistic and subject to a sensitivity analysis.

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<sup>51</sup> Aviation Guidelines, paragraph 63

In particular, with regard to airports, investments into infrastructure are frequent. Since the *Aéroport de Paris* and *Leipzig/Halle* judgments of the CJEU construction of airport infrastructure cannot be viewed separately from the subsequent operation of the airport, which constitutes an economic activity. Therefore, financing of airport infrastructure can fall within Article 107(1) TFEU. These investments, often involving very large amounts of financing, should be viewed in the long-term as they will often only result in a positive return after some years.

#### *4. Special consideration on the MEO test applied to airport services and marketing agreements*

This section will take a closer look at the application of the EU state aid rules to airport service agreements and airport marketing agreements. More specifically, the focus shall be on the application of the MEO test to these agreements. There are two different situations which can be looked at in this context:

- where airport marketing and service agreements have been concluded between an airport and an air carrier; and,
- where a marketing agreement has been concluded between an entity that has no link to the airport in question and an air carrier.

The Commission will follow a different approach to these distinct cases; each will be covered in turn. Finally, an overview of Commission Decisions on airport service and marketing agreements will be provided.

Before moving on, the use of the term “marketing agreement“ needs to be clarified. Marketing agreements could refer to different types of agreements, ranging from:

- the classical marketing agreement, whereby an airport supports an airline for new routes by providing a grant covering the costs for promoting these routes; to
- other marketing agreements, whereby the airport pays the air carrier financial compensation for the provision of marketing services by promoting the airport.

In the following sections, the term “marketing agreement“ will refer to the latter type of agreements.

##### *i. Agreements between airports and air carriers*

The Commission has in practice not accepted that a marketing agreement as defined above between an airport operator and airline can constitute a genuine marketing agreement. The Commission has regarded these types of agreements as a different form of support to the air carrier, rather than compensation for a genuine service. Therefore, as can be seen below in the overview of Commission Decisions, the Commission has consistently analysed the airport service agreements and marketing agreements jointly. They have been considered to be interrelated agreements.

For this reason, the Commission will take the marketing fees paid by the airport to the air carrier as incremental costs, and also consider any increased passenger flows resulting from the marketing activities for the purpose of conducting the *ex ante* incremental profitability analysis.

The *ex ante* incremental profitability analysis is also applied to overall schemes of airport charges. This is clear from the wording in the Aviation Guidelines, and has also been seen in the Commission's Decision making practice.<sup>52</sup> Thus when a scheme has been put in place for airport charges, an *ex ante* incremental profitability analysis will only need to be conducted for this scheme. Any individual agreement entered into by the airport and air carrier that falls within this scheme will not require an additional *ex ante* incremental profitability analysis to be conducted. However, when an individual agreement between an airport and air carrier goes beyond the established scheme, or falls outside of the scope of the scheme for any other reason, an *ex ante* incremental profitability analysis will need to be conducted for these individual agreements.

*ii. Marketing agreements between air carriers and entities with no link to the airport in question*

The Commission will consider an additional preliminary question before conducting the MEO test to agreements between an air carrier, and a body invested with a general interest task. The Commission will assess whether 1) the entity invested with a general interest task entered into the marketing agreements in the context of its role as an airport operator, and thus whether its conduct must be compared with that of a hypothetical airport operator motivated by economic profits, or alternatively 2) the entity invested with a general interest task, when concluding the marketing agreements, acted within the context of its general interest mission, which could, for instance, be the economic development the region.

It is presumed that where the entity that entered into a marketing agreement with the air carrier has no link to the airport or airport operator, then this entity cannot have acted as an airport operator. Therefore the second approach will be followed.

Under this approach there are two requirements which need to be fulfilled in order to consider that the entity acted like an MEO:

- The services in question must meet the actual needs of the public purchaser; and
- They must have been purchased at a price equal or below the market price.

Regarding the requirement that the services must meet the actual needs of the public purchaser, the Commission has held that it is possible that a local authority may feel the need to resort to commercial providers in order to promote the area. However, under this requirement the measure may not target the commercial activities of clearly defined undertakings. Thus the marketing activities would need to promote the region in general, rather than target the operation of routes from and to the airport in that region by certain airline companies.

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<sup>52</sup> In paragraph 63 of the Aviation Guidelines it is stated that “*The airport should demonstrate that, when setting up an arrangement with an airline (for example, an individual contract or an overall scheme of airport charges), it is capable of covering all costs stemming from the arrangement [...]*”.



Furthermore, concerning the question of the market price of the marketing services, it is normally expected that expenditure is minimised by organising an invitation to tender, or at least consulting several providers and comparing offers. This is particularly the case for services for which there are no clear market price benchmarks, which holds true for marketing services.

### *iii. Commission Decisions*

In order to fully understand how the Commission addresses airport service and marketing agreements, an overview will be provided of Commission Decisions concerning such agreements. This overview has been divided into three separate tables covering:

- Negative Commission Decisions on airport services and marketing agreements;
- Positive Commission Decisions on airport services and marketing agreements;
- Commission Decisions containing a mix of positive and negative elements.

It can be seen that the balance between positive and negative outcomes seems to be relatively balanced.

The following Commission Decisions are covered:

- Commission Decision on State aid SA.22614 (C 53/07) implemented by France in favour of the Chamber of Commerce and Industry of Pau-Béarn, Ryanair, Airport Marketing Services and Transavia (“**Pau-Pyrénées Airport Decision**”) of 23 July 2014;
- Commission Decision on State aid SA.33963 (2012/C) (ex 2012/NN) implemented by France in favour of Angoulême Chamber of Commerce and Industry, SNC-Lavalin, Ryanair and Airport Marketing Services (“**Angoulême Airport Decision**”) of 23 July 2014;
- Commission Decision on State aid SA.33983 (2013/C) (ex 2012/NN) (ex 2011/N) – Italy Compensation to Sardinian airports for Public Service Obligations (SGEI) (“**Sardinian Airports Decision**”) of 29 July 2016;<sup>53</sup>
- Commission Decision on the measures SA.22030 - 2007/C, SA.29404 and SA.32091 - 2012/C - Germany Financing arrangements regarding Flughafen Dortmund GmbH and the schedules of airport charges NERES and NEO (“**Dortmund Airport Decision**”) of 23 July 2014;
- Commission Decision on the State Aid SA.26190 (2012/C) (ex 2011/NN) implemented by Germany for Saarbrücken Airport and airlines using the airport (“**Saarbrücken Airport Decision**”) of 1 October 2014;
- Commission Decision on State Aid SA.18857 (2012/C, ex 2011/NN) Alleged aid to Västerås Airport and Ryanair Ltd (“**Västerås Airport Decision**”) of 1 October 2014;

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<sup>53</sup> The final Decision has not yet been published. Therefore this overview has been provided on the basis of information available in the opening decision, and in the Commission’s press release regarding the final decision. See [http://europa.eu/rapid/press-release\\_IP-16-2682\\_en.htm](http://europa.eu/rapid/press-release_IP-16-2682_en.htm).

- Commission Decision on State aid SA.33961 (2012/C) (ex 2012/NN) implemented by France in favour of Nîmes-Uzès-Le Vigan Chamber of Commerce and Industry, Veolia Transport Aéroport de Nîmes, Ryanair Limited and Airport Marketing Services Limited (“**Nîmes airport Decision**”) of 23 July 2014;
- Commission Decision on the State Aid SA.27339 (2012/C) (ex 2011/NN) implemented by Germany for Zweibrücken airport and airlines using the airport (“**Zweibrücken Airport Decision**”) of 1 October 2014;
- Commission Decision on state aid SA.26500 - 2012/C (ex 2011/NN, ex CP 227/2008) implemented by Germany for Flugplatz Altenburg-Nobitz GmbH and Ryanair Ltd (“**Leipzig-Altenburg Airport Decision**”) of 15 October 2014;
- Commission Decision on State aid SA.23098 (C 37/07) (ex NN 36/07) implemented by Italy in favour of Società di Gestione dell'Aeroporto di Alghero So.Ge.A.AL S.p.A. and various air carriers operating at Alghero airport (“**Alghero Airport Decision**”) of 1 October 2014.

**Table: Negative Commission Decisions on airport services and marketing agreements**

Airport(s) affected	Granting authority	State aid circumstances	EC approach and outcome
Pau-Pyrénées airport (France)	The Chamber of Commerce and Industry of Pau-Béarn (the CCIPB), which is the operator of Pau-Pyrénées airport. The Commission finds the CCIPB to be a public authority (paragraph 276).	<p><b><u>Background</u></b>  Pau-Pyrénées airport was originally owned by the state, but on 1 January 2007 the State transferred ownership of the airport to a group of local authorities known as the syndicat mixte de l'aéroport Pau-Pyrénées. The CCIPB was the airport operator both before, and after the transfer of ownership of the airport.  Aside from Ryanair, the main commercial air carrier using Pau airport is Air France. Other air carriers have also used the airport during the period under review, in particular Transavia, which is a subsidiary of the Air France KLM group.  Airport Marketing Services (AMS) is a fully owned subsidiary of Ryanair which deals with its marketing business.</p> <p><b><u>Measures</u></b>  This overview shall only cover the measures related to airport services and marketing agreements between the airport and air carriers.</p> <p>1) Agreement of 28 January between CCIPB and Ryanair on airport services and marketing services (Section 4.1.1). This agreement relates in particular to the set-up of the route between Pau and London. This includes a payment of 80,000 EUR to Ryanair by CCIPB for setting up the route.</p>	<p><b><u>Preliminary questions relating to the MEO test</u></b></p> <p>1) The Commission finds that the marketing service agreements and the airport service agreements, for the purpose of determining an advantage, should be assessed as a single transaction (paragraphs 286-313). This was based on the considerations that the agreements were signed at virtually the same time (paragraph 289); the agreements were signed by the same parties (paragraph 290); and the very close ties between the marketing and airport service agreements – mainly due to the fact that the marketing service agreements do not promote Pau and its region in general, but rather the flights of that particular air carrier from and to Pau airport (paragraphs 291-313).</p> <p>2) The Commission furthermore concludes that the appropriate approach would be to compare the conduct of CCIPB with that of a hypothetical airport operator motivated by the prospect of profits (opposed to that of a public body entrusted with a general interest mission) (paragraphs 314-331). This is concluded for the following reasons:  - comparing the conduct of CCIPB to that of a public body acting with a general interest mission would disregard the close links between the marketing and airport service agreements. If one was to compare the conduct of CCIPB to that of a public body, this would mean that it would be accepted that the CCIPB signed the marketing services agreements without any regard to the routes offered by Ryanair, and that it would have signed these agreements even in the absence of the routes in question (paragraph 320).  - Even if the conduct of CCIPB would be compared to that of a public body acting entrusted with a general interest mission, this would require that the public purchase would require an “actual need” of the public body. This would however not be fulfilled, as a public entity’s specific task of promoting local economic development would require the promotion of the Pau region in general, and not promoting the services of one or more clearly defined entities. A public entity should assume that a local undertaking must finance its own marketing operations, and that its own marketing activities are limited to the general promotion of the area. This point will be elaborated on below.</p> <p>3) The Commission concludes that the only benefit that an MEO could expect from a marketing service agreement (which would need to be taken into account together with an airport services agreement) would be the increase in passengers using the particular route being advertised, for the duration of the operating period of those routes (paragraphs 332–358). Although such an increase does primarily benefit the air carrier, it also benefits the airport operator as it will lead to an</p>

		<p>2) The 2005 agreements which encompass a) The marketing services agreement signed by the CCIPB with AMS (see Sections 3.1.1 and 4.1.2). The purpose of the marketing services agreement is to 'determine the conditions under which Airport Marketing Services will provide CCIPB with specific marketing services intended to promote the various tourist and business attractions in the Pau/Bearn region'. b) The airport services agreement signed by the CCIPB with Ryanair (see Sections 3.1.2 and 4.1.2). It sets out how the infrastructure of Pau airport is to be made available to the carrier, particularly with regard to ground handling services and the provision of private premises.</p> <p>3) Various agreements signed between AMS/Ryanair and the CCIPB after 2005 (see Section 4.1.3). This includes service agreements related to new routes, and amendments to the original 2005 agreements.</p> <p>4) Agreement signed by the CCIPB and Transavia in 2006 related to marketing services for the Pau-Amsterdam route (see Section 4.2). This agreement resulted in payments totalling EUR 700 000 to 900 000 by the CCIPB to Transavia for the marketing services provided by the latter between 26 April 2006 and 29 October 2009.</p>	<p>increase of revenue from airport charges, provision of ground handling services, and non-aeronautical services.</p> <p>4) The Commission finds the MEO test should be applied by means of an <i>ex ante</i> incremental profitability analysis (paragraph 370).</p> <p>The Commission sets out the incremental traffic, incremental revenues, and incremental costs that should be taken into account for the purpose of the MEO test (paragraphs 398-428).</p> <p><b>Conclusions</b> For all the agreements between CCIPB and Ryanair/AMS the Commission concludes that the incremental flows were negative. The agreements therefore conferred an advantage on Ryanair and Transavia (paragraphs 429-440). The agreements, furthermore, fulfil the remaining conditions in Article 107(1) TFEU, and therefore constitute state aid.</p> <p><b>With regard to the market price of the marketing activities</b> As explained above, for the application of the MEO test, there are two options for its application. Option 1: consider the CCIPB signed the marketing agreements as the airport operator, and thus compare the conduct with that of a hypothetical airport operator motivated by economic profits (this is the option eventually chosen by the Commission). Option 2: consider the CCIPB acted as a public body entrusted with a general interest mission, which in this case would be the economic development of Pau and its region. Under Option 2 there are two requirements: 1) the services in question must meet the actual needs of the public purchaser, and 2) they must have been purchased at a price equal or below the market price. - Regarding requirement 1 (actual needs): it is possible that a local authority may feel the need to resort to commercial providers in order to promote the area. However in this case the promotion targets the commercial activities of two clearly defined undertakings (see paragraphs 323-326). - Regarding requirement 2 (market price): it is normally expected that expenditure is minimised by organising an invitation to tender, or at least consulting several providers and comparing offers. This is particularly so regarding services for which there are no clear market price benchmarks, which is the case for marketing services (paragraph 327).</p>
Angoulême airport (France)	The aid was formally granted by Syndicate mixte des aéroports de Charente (SMAC).	<p><b>Parties involved</b> Angoulême airport was owned by the state until 22 December 2006 when ownership was transferred to SMAC. From 2007 all investments and financing of the airport</p>	<p><b>Preliminary questions relating to the MEO test</b> When looking at the selectivity of the measure, the Commission first addresses various preliminary matters: - The Commission finds that the Marketing Service Agreement and Airport Service Agreement should be looked at together (paragraphs 304-313). Among other reasons (<i>e.g.</i> the contracts were</p>

	<p>However, the Commission assesses the behaviour of SMAC together with Angoulême CCI/CCI-airport, as at the time they jointly operated Angoulême airport.</p> <p>- SMAC is a syndicate of Chambers of Commerce and Industry, local authorities, and public bodies made up of local authorities.</p> <p>- Angoulême CCI is a public administrative body.</p>	<p>were the responsibility of SMAC.</p> <p>On 20 September 2002 Angoulême CCI (who is part of SMAC) received a 5-year concession over the airport through which it was responsible for the airport's construction, maintenance and operation. This concession was extended by SMAC until 31 December 2008. From 1 January 2009 Angoulême CCI and SMAC entered into a 3-year management subcontracting agreement. From this date investments undertaken for airport operations were the responsibility of SMAC instead of Angoulême CCI. Angoulême CCI acting as the airport manager and operator had separate accounting from Angoulême CCI's general accounting, and is referred to as CCI-airport.</p> <p>From 1 January 2012 the management and operation was the responsibility of SNC-Lavalin, a private undertaking.</p> <p><b><u>Measures</u></b></p> <p>The Decision covers various measures related to financial support to the airport. However these will not be covered for the purpose of this overview.</p> <p>Angoulême CCI took four successive airport fee decisions (2003, 2005, 2009, and 2010), of which the latter two were approved by SMAC. On 8 February 2008 SMAC entered into two agreements:</p> <p>- An Airport Service Agreement with Ryanair in which Ryanair agreed to operate the route Angoulême-London Stanstead three flights a</p>	<p>concluded on the same date, and also Ryanair and AMS are considered to be a single economic entity), the Commission finds that the marketing service agreement is linked to Ryanair's operation of the route.</p> <p>- The Commission finds that the only benefit that a MEO would expect from a marketing service agreement and would quantify, and thus resort to when deciding whether to enter into the agreement or not, is the positive effect on the number of passengers using the route covered in the agreement, for the term of the operation of this route (paragraphs 314-338). The increase in passenger traffic will benefit the airport as it may lead to an increase in revenues generated by certain airport charges and other non-aeronautical services at the airport.</p> <p>- The Commission holds that, as recommended in the Aviation Guidelines, the MEO test should be applied by means of an <i>ex ante</i> incremental profitability analysis.</p> <p>The Commission holds that the absence of a business plan (or any quantitative cost-benefit analysis carried out prior to the conclusion of the agreement) is a serious indication that the MEO principle was not complied with (paragraph 360).</p> <p>When applying the MEO test, the Commission sought to establish the incremental revenues generated by the transaction like a market economy operator would have foreseen it (based on the increase in passenger flows), and the incremental costs that could normally be expected from each transaction by a market economy operator managing the airport. An overview is seen in paragraph 387.</p> <p><b><u>Conclusions</u></b></p> <p>- The MEO test results in a negative expected annual incremental flow resulting from the 2008 marketing service and airport service agreements (despite making some favourable assumptions for Ryanair regarding passenger flow and incremental costs). Therefore it is concluded that the agreements confer an economic advantage on Ryanair and AMS (paragraphs 388-389).</p> <p>- The remaining conditions for state aid have also been fulfilled and thus the marketing service and airport service agreements constitute state aid as defined under Article 107(1) TFEU.</p>
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		<p>week during the summer, and SMAC granted Ryanair certain reductions for airport charges.</p> <p>- A Marketing Service Agreement with AMS (a fully owned subsidiary of Ryanair): This agreement was based explicitly on Ryanair's operation of the above-mentioned route. AMS would undertake marketing services in return for a payment my SMAC.</p> <p>The above-mentioned agreements were, in practice, not implemented after 2009.</p>	
Cagliari and Olbia airports (Italy)	The Region of Sardinia.	<p><b><u>The airport operators</u></b></p> <p>Cagliari's airport operator SOGAER is publicly held undertaking. Olbia's airport operator GEASAR, has a majority of private shareholders.</p> <p><b><u>The Scheme</u></b></p> <p>Aid scheme which has been established by Article 3 of Law 10/2010. The aid was granted by the Sardinian Region in the form of direct grants to Sardinian airport operators, which in turn were to channel the public financing to airlines. The objective of this scheme was to ensure air connections to and from the island of Sardinia.</p>	<p>The Commission found that there was no aid granted to the airports because the public funding was passed on in full to the airlines. On the other hand, the Commission did find state aid to be granted to the airlines.</p> <p>In the Commission's press release it is stated that:</p> <p><i>“Concerning aid to selected airlines operating at Cagliari and Olbia airports, the Commission found that financial compensation was granted by the airports to the airlines for the opening of new routes or extension of operations on existing routes to Sardinia. This provided a financial incentive for the selected airlines to increase air traffic to Sardinia. Furthermore, the selected airlines also received financial compensation from the airports for carrying out marketing operations that are a part of their normal business. Therefore, the Commission found that the agreements involve state aid in favour of the selected airlines flying to and from Sardinia.”</i></p>

**Table: Positive Commission Decisions on airport services and marketing agreements**

Airport(s) affected	Granting authority	State aid circumstances	EC approach and outcome
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<p>Dortmund Airport (Germany)</p>	<p>The aid was granted by Flughafen Dortmund GmbH (FD), who is the airport operator of Dortmund Airport. 26% of FD is owned directly by the City of Dortmund. The remaining 74% is owned by Dortmunder Stadtwerke AG, which is fully owned by the City of Dortmund.</p>	<p><b><u>Measures</u></b></p> <p>There are multiple measures looked at in this decision. For the purpose of this overview, only those related to airport service agreements and airport marketing agreements will be looked at.</p> <ul style="list-style-type: none"> <li>- The New and Existing Routes Expansion Scheme (NERES) schedule of airport charges: FD introduced NERES on 1 July 2004, and it was applicable until 30 June 2009. Under the scheme air carriers were granted a marketing contribution per passenger, and a discount on the uniform airport-use charge per plane, depending on the total yearly passenger traffic flow of the air carrier. Air carriers could apply for the scheme for each new connection, and for all existing connections. NERES was applied simultaneously with FD's schedule of charges (the 2000 scheme). For connections benefitting from NERES, the NERES scheme was applied instead of 2000 scheme.</li> <li>- The New schedule of airport charges (NEO) schedule of airport charges: NEO was introduced on 1 July 2009. Take-off and landing charges were charged uniformly for scheduled flights under NEO. For non-scheduled flights NEO distinguished between take-off and landing charges. Ground handling agreements were determined through individual contracts between the air carriers and airport for scheduled flights. A volume based discount was granted depending on the number of passengers. For non-scheduled flights, the charges for ground handling</li> </ul>	<p><b><u>NERES MEO test</u></b></p> <p>The Commission applies the MEO test to FD my means of an ex ante incremental profitability analysis. NERES is to be viewed as an overall scheme of airport charges. FD is characterised by high fixed costs (both investment and operation) due to the extensive construction of its infrastructure before 2000. A financial and traffic forecast made by FD (before implementing NERES) indicated a sharp decrease of passengers if the 2000 scheme would continue to apply with higher charges as a generally applicable scheme. It also showed that from 2004-2009 NERES would have a positive incremental profitability. This was expected independently of the base-, worst-, and best-case scenarios. Due to the high fixed costs of the airport, and also limited incremental costs resulting from NERES (only marketing costs were directly attributable to the air carriers), these forecasts were not sensitive to the assumptions regarding the traffic development at the airport. Ex post data shows that NERES indeed resulted in positive incremental profitability. When making an ex ante profitability assessment, the Commission will take into account the extent to which the arrangements can be considered part of the implementation of an overall strategy of the airport expected to lead to profitability at least in the long-run. In this context the following market conditions were relevant:</p> <ul style="list-style-type: none"> <li>- market changes induced by the liberalisation of the air transport market;</li> <li>- The rise of low-cost carriers and other point-to-point carriers;</li> <li>- changes in the organisational and economic structure of the airport industry</li> <li>- the degree of diversification and complexity of the functions undertaken by airports;</li> <li>- the increased competition between air carriers and airports;</li> <li>- the uncertain economic environment.</li> </ul> <p>Finally, the Commission also finds that the airport infrastructure and NERES scheme were open to all interested air carriers without undue discrimination.</p> <p><b><u>Conclusion NERES</u></b></p> <p>The Commission found that no advantage was granted to air carriers under NERES, and thus NERES does not constitute state aid under Article 107(1) TFEU.</p> <p><b><u>NEO MEO test</u></b></p> <p>Also with respect to NEO the Commission applies the MEO test to FD my means of an ex ante incremental profitability analysis. NEO is to be viewed as an overall scheme of airport charges. As for NERES, a financial and traffic forecast was made for NEO before its implementation, comparing it to alternative choices (to introduce the 2000 scheme with higher airport charges, introduce NEO with lower airport charges, or introduce a mix of these two schemes).</p>
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		<p>services depended on the size of the aircraft. Passenger services were calculated on the basis of individual contracts. De-icing was priced on the basis of MTOW.</p>	<p>Application of the 2000 scheme, or a mixed scheme would result in a sharp decrease in the number of passengers.</p> <p>From the first year of its introduction, NEO was expected to have a positive incremental profitability, independently of the base-, worst-, and best-case scenarios.</p> <p>As for NERES, due to the high fixed costs of the airport, and also limited incremental costs resulting from NEO, these forecasts were not sensitive to the assumptions regarding the traffic development at the airport.</p> <p>Ex post data shows that NEO indeed resulted in positive incremental profitability.</p> <p>With regards to the extent to which the arrangements can be considered part of the implementation of an overall strategy of the airport, as has been seen above for NERES, the same market conditions have been taken into consideration for NEO.</p> <p>Finally, also for NEO the Commission finds that the airport infrastructure and the scheme were open to all interested air carriers without undue discrimination.</p> <p><b><u>Conclusion NERES</u></b></p> <p>It is concluded that NEO does not confer an economic advantage on the air carriers, and thus does not constitute state aid as defined under Article 107(1) TFEU.</p>
<p>Saarbrücken Airport (Germany)</p>	<p>The first measure that will be discussed was issued by the Flughafen Saarbrücken Betriebsgesellschaft mbH ("FSBG"), the airport operator between 1997 and 2008. The second measure that will be covered in this overview was issued by Flughafen Saarbrücken GmbH ("FSG"), the owner and operator of the airport before 1997, and again after 2008.</p>	<p><b><u>Background</u></b></p> <p>For the purpose of this decision it is necessary to have an understanding of how the set-up of the parties evolved over time.</p> <p>In 1997, Flughafen Saarbrücken GmbH, previously owner and operator of the Airport, was split up into two separate companies: FSBG was charged with operating the airport, while the Flughafen Saarbrücken Besitzgesellschaft mbH ("FSBesitzG") owned the airport and was in charge of maintaining the infrastructure. In return for operating and commercially exploiting the airport, the FSBG had to pay a leasing payment to FSBesitzG.</p> <p>Until 30 June 2007, the FSBG was 48% owned by the FSBesitzG, 51% by the Fraport AG (operator of Frankfurt (Main) Airport) and 1% by the City of Saarbrücken. The FSBesitzG was, in turn, 99.9% owned by vh Saar and 0.1% by the Land Saarland. The vh Saar was at</p>	<p>The Commission looks at the overall scheme of airport charges, and also at the individual marketing agreement with Air Berlin.</p> <p>- The Commission first assesses the scheme of airport charges which allows for discounts in certain situations. It does this by means of an <i>ex ante</i> incremental profitability assessment. Considering that some air carriers had moved away from the airport, its capacity was only being utilised at 50%. Therefore providing the extra services had almost no incremental costs. Furthermore, the discounts were only granted to new or increased business. Taking this into consideration, and also the difficult business situation that the airport found itself in, the agreement was found to be in accordance with MEO test (paragraph 340).</p> <p>- Concerning the Marketing agreement with Air Berlin, it is also analysed on the basis of <i>ex ante</i> incremental profitability. Although this is not explained in the description of the measure under Section 2.2.7, it is stated in the MEO test assessment in paragraph 341 that the marketing agreement also included the obligation for Air Berlin to increase the frequency of its flights to and from Berlin and another destination (the destination has been withdrawn from the Decision). These are the two connections that Air Berlin would promote. Due to the increased frequency of the flights, and also the fact that the only incremental costs were the direct marketing payments to Air Berlin, the agreement was expected to be profitable by Air Berlin from an <i>ex ante</i> point of view. The Commission is convinced by the airport's</p>



		<p>all times owned directly by the Land Saarland. On 30 June 2007, the Fraport AG sold its share in the FSBG to the FSBesitzG, who subsequently owned 99% of the FSBG. At the beginning of 2008, the two companies were merged to re-establish the FSG, thereby re-creating the situation as it existed before the partial privatisation to Fraport AG in 1997. Since 2008 and until now, FSG is 100% owned by vh Saar.</p> <p><b><u>The Measures</u></b> The Decision covers various measures, however only one of these relates to airport service agreements and marketing agreements.</p> <p>From April 2007 onwards FSBG introduced a new schedule which provided for a series of discounts available to air carriers that fulfilled certain conditions, namely (see Section 2.2.5): a) air carriers operating from the airport for the first time, b) air carriers serving new destinations, c) air carriers that have increased their passenger numbers.</p> <p>Furthermore, FSG concluded a marketing agreement with Air Berlin (see Section 2.2.7). Air Berlin was obliged to deliver marketing and publicity services to FSG, and they would also promote two connections from and to the airport.</p>	<p>report. Therefore the agreement with Air Berlin is found to be in accordance with the MEO test (paragraph 344).</p> <p><b><u>Conclusion</u></b> The overall scheme of airport charges, including the discounts contained therein, and also at the individual marketing agreement with Air Berlin did not confer an advantage on the recipients. These measures do therefore not constitute state aid as defined under Article 107(1) TFEU.</p>
Västerås airport (Sweden)	Västerås Flygplats AB (VFAB), who is the operator of Västerås airport.	<p><b><u>Background</u></b> The Decision concerns Västerås airport, which is a small airport located approximately 100 km west of Stockholm. VFAB is an undertaking established by the City of Västerås. VFAB has been a fully</p>	<p><b><u>Imputability</u></b> The Commission considers that the City Council was directly involved in devising VFAB's future commercial strategy, and therefore it must be considered as involved in the decisions taken by VFAB in implementing this decision, including the commercial arrangements with Ryanair and AMS (paragraphs 221-225).</p>

publicly owned company during the whole period covered by the decision. VFAB owned the airport infrastructure which it operated until 2003 when the infrastructure was sold to Västerås Flygfastigheter AB, a company owned by the city of Västerås, to which VFAB pays rent for the use of the airport. Ryanair is the air carrier benefitting from the aid, and Ryanair Airport Marketing Services (AMS) is a fully owned subsidiary which handles marketing matters.

#### **Measures**

There were various measures covered in this Decisions, however only those related to airport services and marketing agreements will be covered in this overview.

1) The airport charge agreements between VFAB and Ryanair: There is no set price list for airport charges, and therefore VFAB is free to set on its charges. Since 2001 Ryanair has had three different agreements with VFAB. Under the 2001 agreement Ryanair committed to operate on a daily basis the route London Stansted-Västerås, and other points on Ryanair's network. Furthermore Ryanair would guarantee a minimum amount of passengers per year. In return Ryanair will pay a certain amount of airport charges per departing passenger. In addition VFAB would pay Ryanair marketing support towards measures to promote the Ryanair flights from and to Västerås. The second agreement (an addendum to the 2001 agreement), signed in 2003, simply changed the airport passenger charges. Finally, the 2005 agreement, replacing

#### **MEO test**

The following preliminary points are addressed by the Commission prior to applying the MEO test:

- The airport service agreements and the marketing agreements must be evaluated together as one single measure. Although some of the agreements are signed by Ryanair and others by AMS, these are to be considered as a single economic entity. Furthermore, the Commission finds that the marketing service agreements and airport service agreements are indivisibly linked to one another. Without the marketing service agreements the airport service agreements would not have been signed.
- The Commission finds that the appropriate way of applying the MEO test is through an *ex ante* incremental profitability assessment.

The assessments of the expected future profitability of the agreements made at the time the agreements were entered into indicated that the agreements were expected to be profitable for the airport. In particular, due to under-utilisation of the airport, the incremental costs resulting from Ryanair's operations were expected to be relatively limited.

The Commission notes the following circumstances that are relevant for its decision:

- Västerås airport was struggling as its traditional airport customers considering cutting down their activities at the airport, and not willing to commit to long-term agreements.
- The fact that low-cost air carrier's market shares in Europe were expected to rise significantly.
- Contrary to SAS who was reducing its operations at the airport (and other traditional air carriers), Ryanair was prepared to envisage long-term contractual agreements and guarantee a minimum amount of annual passenger.

When making an ex ante profitability assessment, the Commission will take into account the extent to which the arrangements can be considered part of the implementation of an overall strategy of the airport expected to lead to profitability at least in the long-run. In this context the following market conditions were relevant:

- market changes induced by the liberalisation of the air transport market;
- The rise of low-cost carriers and other point-to-point carriers;
- changes in the organisational and economic structure of the airport industry
- the degree of diversification and complexity of the functions undertaken by airports;
- the increased competition between air carriers and airports;
- the uncertain economic environment.

It is also held that the infrastructure at Västerås Airport is open to all air carriers and not

	<p>the 2001 agreement and 2003 addendum, altered the amount of rotations per day, and also changed the amount of airport charges.</p> <p>2) Marketing agreements were signed between VFAB and Ryanair/AMS in 2008 and 2010 respectively.</p>	<p>dedicated to a specific air carrier.</p> <p><b>Conclusion</b> The Commission concludes that VFAB did act like a prudent MEO, and therefore the agreements did not confer an advantage on Ryanair and AMS. Therefore there is no state aid as defined under Article 107(1) TFEU.</p>
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**Table: Commission Decisions containing a mix of positive and negative elements**

Airport(s) affected	Granting authority	State aid circumstances	EC approach and outcome
Nîmes airport (France)	<p>- Nîmes-Uzès-Le Vigan Chamber of Commerce and Industry (the CCI) is a member of the network of chambers of commerce and industry. In France, chambers of commerce and industry are public administrative bodies. Until 2006 the CCI was the operator of the civilian part of Nîmes airport.</p> <p>- Veolia Transport Aeroport de Nîmes (VTAN), acting</p>	<p><b>Parties involved</b> The Decision concerns Nîmes airport in France. Until 2011 Nîmes airport was mainly a military aerodrome, with civil aviation forming only a secondary activity. CCI was entrusted with operating the civilian area of the airport from 1965. This involved establishing, equipping, maintaining and operating the structures, buildings, facilities and equipment. The Syndicat Mixte pour l'aménagement et le développement de l'aéroport de Nîmes-Alès-Camargue-Cévennes (SMAN) is a public body created by Order of the Prefect of the Gard Department of 9 December 2005. From 1 February 2006 responsibility for the equipment, maintenance, operation and development of the civilian area of the aerodrome was entrusted to the SMAN through an agreement. Under this agreement, the civilian area of the airport was placed at the disposal of the SMAN, with the state</p>	<p><b>Preliminary questions relating to the MEO test</b> The Commission addresses various preliminary questions before applying the MEO test. 1) In the light of the Charleroi judgment and SMAN's influence on VTAN's commercial policy towards Ryanair and AMS, the conduct of VTAN must be assessed together with the conduct of SMAN (paragraphs 307-309). It seems however that this is only to the extent that VTAN's conduct is assessed "in the light of SMAN's influence, considering that SMAN's funding of VTAN is assessed as a separate measure (paragraph 554 <i>et seq.</i>). 2) The Commission finds that the airport service and marketing agreements must be assessed together as they have been signed on the same date, between the same parties, and there is a very close link between each of the agreements (paragraphs 310-329). 3) The Commission assesses the method for applying the MEO test to the Operators for looking at the marketing service agreements (paragraphs 330-346). - The Commission can either consider the Operators signed the marketing agreements as the airport operator, and thus compare the conduct with that of a hypothetical airport operator motivated by economic profits, or alternatively consider the Operators acted as public bodies entrusted with a general interest mission, which in this case would be the economic and tourism development of area (paragraphs 331-332). - The Commission opts for the first option, as applying the second option would disregard the linked nature of the airport services agreements and the corresponding marketing services agreements. Also, even if the second approach was applied, this would not result in the conclusion that the marketing services agreements were in compliance with the MEO test. This will be elaborated on below.</p>

under a public service delegation agreement. VTAN is a subsidiary of a privately owned group.

retaining ownership of the assets. The SMAN chose to subcontract the operation of the aerodrome to the company Veolia Transport under a public service delegation agreement (the CDSP) that took effect on 1 January 2007 and lasted until 31 December 2012. Veolia Transport set up VTAN to fulfil this contract. Ryanair became the main operator at Nimes airport in 2001, and since 2003 has been the only operator offering scheduled services from this airport. Ryanair Airport Marketing Services (AMS) is one of its subsidiaries which handles marketing matters.

#### **The measures**

There are various measures covered in this decision of which the relevant ones (those concerning airport charges and marketing agreements) are described below.

1) CCI entered into various agreements (and amendments of these agreements) with Ryanair and AMS between 2000 and 2005 (see paragraphs 77-91). The agreements concerned the airport fees to be paid by Ryanair, for which Ryanair received a reduction, and also the provision of marketing services by AMS. These agreements were made in the following context (see paragraph 77): The French authorities point out that there was a general balance among the activities pursued at the airport, which was based on the coexistence of the army, industrial enterprises in the aviation field (fuel recycling) and passenger transport activity, with over 2 000

4) Regarding the benefits that an MEO could expect from the marketing service agreements, the Commission finds that the only benefit to be taken into account would be that the marketing services would increase the number of passengers using the routes covered by the agreement (see paragraph 375). This effect is limited to the operating period set out in the agreement for those routes.

- Although the effect of boosting traffic on the routes will mainly benefit the air carrier, it does also benefit the airport operator as an increase in traffic may lead to an increase in revenue from certain airport charges.

5) The Commission finds that an airport operator may have an objective interest in concluding an agreement with an air carrier where it may reasonably expect this to improve its profits. Therefore the method applied in this case should be the *ex ante* incremental profitability analysis (paragraph 391).

In application of the *ex ante* incremental profitability analysis, the Commission sought to establish the incremental revenues generated by the transaction like a market economy operator would have foreseen it (based on the increase in passenger flows), and the incremental costs that could normally be expected from each transaction by a market economy operator managing the airport. This is done for each agreement and subsequent amending agreement in great detail (paragraphs 397-501).

#### **Conclusions**

- The agreement between CCI and Ryanair of 11 April 2000 originally did not confer an advantage on Ryanair, as the annual incremental flows are positive (paragraphs 453-457).  
- The subsequent amendments of this agreement in 2001, 2002 and 2004 resulted in negative annual incremental flows, and therefore did confer an advantage (paragraphs 458-462). The amendment entailed an increase in the marketing payments by CCI, subject to the condition that Ryanair would add an additional daily flight. Ryanair was not obliged to provide additional marketing services.  
- The 2005 agreement between CCI and Ryanair also resulted in a negative incremental flow, and thus conferred an advantage on Ryanair (paragraphs 468-473).  
- All the agreements and subsequent amendments signed between VTAN and Ryanair/AMS covered in this Commission Decision had a negative expected incremental flow, and thus conferred an advantage on Ryanair/AMS.

The agreements listed above that resulted in an advantage for Ryanair/AMS also fulfilled the remaining conditions under Article 107(1) TFEU and thus constitute state aid.

		<p>jobs being at stake. In this economic context, the CCI, firstly on its own and subsequently with its partner local and regional authorities, sought to maintain the routes operated from Nîmes airport.</p> <p>2) After VTAN became responsible for the operation of the airport, similar agreements as described under Measure 1 were also concluded between VTAN and Ryanair/AMS (see paragraphs 92-102). The Commission finds that VTAN's commercial policy towards Ryanair and AMS was influenced by SMAN through the CDSP. The obligations imposed by this agreement went beyond mere operation of the airport and covered "economic and tourist development of the area". In addition the profitability of the concession of VTAN relied on the subsidy paid by SMAN.</p>	<p><b><u>With regard to the market price of the marketing activities</u></b></p> <p>As explained under the third preliminary question answered by the Commission for the application of the MEO test, there are two options for the application of the MEO (see paragraphs 330-345). Option 1: consider the Operators signed the marketing agreements as the airport operator, and thus compare the conduct with that of a hypothetical airport operator motivated by economic profits (this is the option eventually chosen by the Commission). Option 2: consider the Operators acted as public bodies entrusted with a general interest mission, which in this case would be the economic and tourism development of area. The CCI is invested by law with this task, and VTAN was entrusted with this task by SMAN through the CDSP.</p> <p>Under Option 2 there are two requirements: 1) the services in question must meet the actual needs of the public purchaser, and 2) they must have been purchased at a price equal or below the market price.</p> <ul style="list-style-type: none"> <li>- Regarding requirement 1 (actual needs): it is possible that an entity such as CCI or VTAN may feel the need to resort to commercial providers in order to promote the area. However in this case the promotion targets the commercial activities of two clearly defined undertakings (see paragraphs 332-342).</li> <li>- Regarding requirement 2 (market price): it is normally expected that expenditure is minimised by organising an invitation to tender, or at least consulting several providers and comparing offers. This is particularly the case for services for which there are no clear market price benchmarks, which is the case for marketing services (paragraph 344).</li> </ul>
Zweibrücken Airport (Germany)	The airport owner and operator, Flughafen Zweibrücken GmbH (FZG).	<p><b><u>Parties involved</u></b></p> <p>Zweibrücken Airport is owned and operated by FZG, who is a fully owned subsidiary of Flugplatz GmbH Aeroville Zweibrücken (FGAZ). FGAZ in turn is owned by two public entities (Land Rhineland-Palatinate and Zweckverband Entwicklungsgebiet Flugplatz Zweibrücken (ZEF)). FGAZ does not itself carry out any activities related to aviation; it simply passes the public funding on to FZG.</p> <p>Ryanair is one of the air carriers benefitting from the aid, and Ryanair Airport Marketing Services (AMS) is one of its subsidiaries which deals with marketing.</p>	<p>The discounts on airport charges and marketing services agreements with Ryanair are assessed by the Commission from Section 7.3 onwards.</p> <p><b><u>Preliminary questions relating to the MEO test</u></b></p> <p>The Commission addresses various preliminary questions before applying the MEO test.</p> <ol style="list-style-type: none"> <li>1) The airport service agreements and marketing services agreements must be assessed together as a single measure (paragraphs 338-346). This includes the marketing service agreement between Rhineland-Palatinate and AMS and the airport service agreement signed by Ryanair and FZG. These are considered to be indivisibly linked to one another.</li> <li>2) The Commission assesses the benefits an MEO could have expected to gain (paragraphs 347-370).</li> </ol> <ul style="list-style-type: none"> <li>- Although the impact on the passenger flows of marketing services designed to promote air routes will mainly benefit the air carrier concerned, they may also be of benefit to the airport manager (paragraph 349).</li> <li>- Promotional activities such as those undertaken on Ryanair's internet site are highly unlikely to have an effect lasting much longer than the end of the promotion. A campaign will have a more</li> </ul>

### **The Measures**

For our purpose the only relevant measures are those granting aid to the air carriers via the airport:

- Section 3.3. of the Decision. Discounts on airport charges for various air carriers (Ryanair, Germanwings and TUIFly). These discounts are granted in the following situations: a) 100% discount for the first 12 months operating a new route and b) 100% discount for the first 100.000 passengers for air carriers newly operating from the airport.
- Section 3.4. of the Decision. Two marketing service agreements were concluded: a) agreement between Ryanair and FZG, whereby FZG paid Ryanair for the performance of marketing activities and b) a similar contract between Land Rhineland-Palatinate (represented by Ministry of Economics, traffic, agriculture and viticulture) and AMS.

lasting effect when the activities involve one or more media to which consumers are regularly exposed over a given period (355-357).

3) The Commission finds that the appropriate test for applying the MEO test is an ex ante incremental profitability analysis (paragraphs 371-375).

### **MEO test**

In its assessment, the Commission finds that the method used by the German authorities for calculating the incremental revenues is sound (paragraphs 378-381).

The following considerations were put forward by Germany in its assessment:

- (a) The expected passenger numbers were deduced from the envisaged number of flights per week and extrapolated for the duration of the agreement.
- (b) The expected aviation revenues (handling and landing charges, cleaning and de-icing, etc.) were calculated over the duration of the agreement on the basis of the conditions agreed on with each air carrier, taking into account the relevant rebates and incentives.
- (c) The expected non-aviation revenues (parking charges, spending in the terminal, etc.) were also calculated over the duration of the agreement.
- (d) The expected incremental costs were calculated over the duration of the agreement, taking into account depreciation of investments necessary for handling commercial aviation (the new terminal, new check-in counters, parking lots, etc.) as well as additional personnel and materials costs. Only the costs caused by each individual air carrier were taken into account. On that basis, Germany argued that the costs of the new terminal and if hiring new staff were originally caused by Germanwings taking up business from Zweibrücken, so that those costs were mostly allocated to the first Germanwings contract.
- (e) At the Commission's request, marketing support payments made to Ryanair under the agreement between the Land and AMS were taken into account as incremental costs of the Ryanair contract.
- (f) The discount rate was based on the discount rates of the German Bundesbank starting from 2008.

It is found that the first Germanwings, the TUIFly, and the Ryanair agreements could not have been expected to result in a positive incremental flow, and thus FGAZ and FZG did not behave like an MEO (paragraph 386). The second Germanwings agreement on the other hand did not constitute an economic advantage (paragraph 387).

### **Conclusion**

- The first Germanwings, the TUIFly, and the Ryanair agreements conferred an advantage to the

			<p>air carriers. In addition, the remaining elements of state aid under Article 107(1) TFEU have also been fulfilled for these agreements, and thus these agreements constituted state aid.</p> <p>- On the other hand, the second Germanwings agreement did not confer an advantage on Germanwings, and therefore does not constitute state aid.</p> <p>The Commission examines the existence of an economic advantage from paragraph 228 onwards.</p>
<p>Leipzig- Altenburg airport (Germany)</p>	<p>Flugplatz Altenburg-Nobitz GmbH, the owner and operator of the airport.</p>	<p><b><u>Background</u></b> Leipzig-Altenburg airport (formerly named Altenburg-Nobitz airport, ‘AOC’) is operated and owned by the publicly owned company Flugplatz Altenburg-Nobitz GmbH. Ryanair is one of the air carriers benefitting from the aid, and Ryanair Airport Marketing Services (AMS) is one of its subsidiaries which deals with marketing.</p> <p><b><u>The Measures</u></b> The Decision covers various aid measures directed at both AOC and Ryanair. For the purpose of this overview the relevant measures are the airport charges and payments to Ryanair by under the airport services and marketing agreements (see Section 3.4.)</p> <p>- The services agreement of 3 March 2003: Flugplatz Altenburg-Nobitz GmbH (named ‘AOC’ in the agreement) and Ryanair entered into a ten year agreement for airport fees.</p> <p>- Three marketing service agreements (2003, 2008, and 2010 respectively) between Flugplatz Altenburg-Nobitz GmbH and Ryanair/AMS (the first one with Ryanair and the two following ones with AMS). The 2003 marketing agreement requires Ryanair to promote the Altenburg area and was valid for 10 years. The 2008 agreement is linked to Ryanair’s commitment to operate a</p>	<p>The Commission first considers that a market price analysis is not the appropriate way to conduct an MEO test (paragraph 235). The Commission thus makes an ex ante incremental analysis of the different agreements, taking the corresponding airport service and marketing agreements together (paragraphs 236-239).</p> <p>The Commission makes three separate ex ante incremental profitability assessments, based on different combinations of agreements. The following conclusions are drawn(240-266):</p> <ol style="list-style-type: none"> <li>1) The airport service agreement of 3 March 2003 and marketing agreement of 7 April 2003 taken together have a positive cash flow (paragraph 249).</li> <li>2) The airport service agreement of 3 March 2003 and the marketing agreements of 7 April 2003 taken together with the marketing agreement of 28 August 2008 also result in a positive cash flow (paragraph 257).</li> <li>3) On the other hand the airport service agreement of 3 March 2003 and the marketing agreement of 7 April 2003 taken together with the marketing agreement of 25 January 2010 were not profitable from an ex ante point of view (paragraph 259).</li> </ol> <p><b><u>Conclusion</u></b> The combination of agreements described under points 1 and 2 above fulfil the MEO test and thus do not confer an advantage on Ryanair/AMS (paragraph 267). These combinations therefore do not constitute state aid as defined under Article 107(1) TFEU. The combination of agreements described under point 3, however, does not fulfil the MEO test and thus confers an advantage on Ryanair/AMS (paragraph 268). The remaining elements of state aid as provided for under Article 107(1) TFEU have also been fulfilled and therefore this combination of agreements constitutes state aid (paragraph 275).</p>



		<p>route to London Stansted and Girona and was valid for 2 years. The 2010 agreement (including the side letter) were linked to London Stansted, Girona and Alicante routes, and were valid for one year.</p>	
<p>Alghero airport (Italy)</p>	<p>So.Ge.A.AL, the airport manager. Although the composition of So.Ge.A.AL's capital varied in the course of the years, since 1994 the company has always been wholly owned by public bodies: the Chamber of Commerce of Sassari, the Province of Sassari, the Municipality of Sassari, the Municipality of Alghero, RAS and SFIRS S.p.A.</p>	<p><b><u>Background</u></b>  Alghero Airport infrastructures and facilities are owned by the State through the Ente Nazionale Aviazione Civile ('ENAC'), which is the Italian National Civil Aviation Authority.  Alghero airport is managed by So.Ge.A.AL. Ryanair has been the main air carrier using the airport since 2000. Ryanair Airport Marketing Services (AMS) is one of its subsidiaries which deals with marketing. However, other air carriers, including other low-cost carriers, have also operated at the airport since 2000 (Germanwings, Air Italy, Air Dolomiti, Air Vallée, Meridiana, Alpi Eagles, bmibaby, easyJet, Air One, Volare, Alitalia)</p> <p><b><u>Measures</u></b>  The Decision covers various aid measures, however for the purpose of this overview only marketing service and airport service agreements between airports and air carriers will be covered.</p> <p>1) Agreements signed by So.Ge.A.AL with Ryanair/AMS (see Section 5.2.1). This includes the Airport Services Agreements signed between Ryanair and So.Ge.A.AL, which laid down Ryanair's operating conditions at Alghero airport and the level of airport charges due by the air carrier. In</p>	<p><b><u>Imputability</u></b>  The Commission found that the local authorities were involved in the decision making surrounding these measures (paragraphs 376-396). This is based on the following: i) the public ownership of So.Ge.A.AL, which translates into the entirety of the votes in the Shareholders Assembly and Board of Directors, ii) public authorities were directly involved in the decision by So.Ge.A.AL to enter the agreements with the air carriers, and iii) the regional authorities have in fact incited the conclusion of the agreements in question.</p> <p><b><u>MEO test</u></b>  The Commission finds that there is no appropriate market benchmark, and therefore the appropriate way of conducting the MEO test is an ex ante incremental profitability assessment (398-417).</p> <p><b><u>Ryanair/AMS agreements</u></b>  The Commission addresses two preliminary issues concerning the agreements with Ryanair/AMS:  1) The airport service agreements and marketing agreements should be assessed together as a single agreement. (paragraphs 418-427)  2) With regard to the benefits an MEO would expect to gain from the marketing service agreements the Commission finds that:  - The assessment should not take into account the general impact on tourism and the region's economy (paragraph 429).  - Although the impact of marketing services designed to promote air routes will mainly benefit the air carrier concerned, they may also be of benefit to the airport manager (paragraph 430).  - The marketing services likely had no effect on passenger traffic after their period of implementation (435-438).</p> <p>A detailed assessment of the incremental flows for each agreement with Ryanair/AMS is undertaken in paragraphs 451-546.  - Italy undertook a 2014 MEOP Report in which it retrospectively determined that the airport service agreements entered into by So.Ge.A.AL with Ryanair had positive net present value cash</p>



addition, this includes the marketing services agreements which relate to the advertising of the Alghero destination on the official website of Ryanair (from 2006 these were concluded with AMS).

These agreements were all signed between 2000 and 2010 and were linked to the operation of particular routes (e.g. Alghero-London).

2) Agreements with other carriers (see Section 5.2.2). This included handling and marketing agreements with Germanwings, Volare, Meridiana, and Alitalia.

flows (paragraph 457).

However, the Commission found that some of the presumptions on which the 2014 MEOP Report was based could not have been presumed by So.Ge.A.AL at the time the agreements were entered in to. For instance, the fact that the 2006 and 2010 airport service agreements with Ryanair were prolonged under the same contractual terms (paragraph 481).

- On the other hand, various presumptions made in the 2014 MEOP Report by Italy were accepted by the Commission. For example the Commission approves that the expansion of the airport infrastructure was not directly linked to the agreement entered into with Ryanair, but that this was necessary due to the general development of tourism in the region (paragraph 489).

- Paragraph 493 shows the outcome of an updated *ex ante* profitability assessment based on the assumptions made by the Commission. Also in light of these assumptions the net present value cash flows are positive for all the agreements between So.Ge.A.AL and Ryanair.

#### **Conclusion on Ryanair/AMS agreements**

It is concluded that the agreements between So.Ge.A.AL and Ryanair are in fact in line with the MEO test and therefore do not constitute state aid (see paragraph 494).

#### **Agreements with other air carriers**

The Commission addresses some preliminary matters before applying the *ex ante* incremental profitability assessment:

- For each of the air carriers the airport service agreement and marketing agreement should be evaluated as a single measure as there is a clear link between these agreements (paragraphs 496-497).

- The Commission also addresses the approach taken by Italy to estimate the incremental costs and revenues to be taken into account for the assessment (paragraphs 525-532 and 539-543).

The Commission finds the following with regard to the net present value flows of the agreements (paragraphs 533-546):

- The agreements between So.Ge.A.AL and Volare, Air One/Alitalia, Air Italy Air Vallee and bmibaby have a positive flow.

- The agreements between So.Ge.A.AL and Meridiana and Germanwings have negative flows.

#### **Conclusion on agreements with other air carriers**

With respect to the other air carriers it is concluded that only the agreements with Meridiana and Germanwings are not in line with the MEO test (see paragraphs 537-538). As the other elements

of state aid under Article 107(1) TFEU have also been fulfilled it is concluded that these agreements constitute state aid.

On the other hand, the agreements between So.Ge.A.AL and Volare, Air One/Alitalia, Air Italy Air Vallee and bmibaby do not constitute state aid.

## *5. Obtaining public funding as an entrepreneur*

It may in some instances be necessary for an entrepreneur to resort to public funding. When it is not possible to obtain the required financing by acting as a private undertaking in accordance with the MEO test, then the public funding will, subject to the fulfilment of the remaining criteria under Article 107(1) TFEU constitute state aid.

De minimis aid, which will be covered first in this section, can be granted under certain conditions. When aid is considered to be de minimis aid, will be considered that it does not fulfil the conditions of Article 107(1) TFEU and therefore does not constitute state aid.

When public financing does fulfil all the conditions under Article 107(1) TFEU, and therefore constitutes state aid, it can be justified and thus held compatible with the internal market under Articles 107(2) and (3) TFEU. The remaining parts of this section will cover specific circumstances in the field of aviation where state aid can be justified in accordance with Article 107(2) or (3).

### a) de minimis aid

A measure will not constitute State aid when the conditions under the de minimis Regulation have been met. Aid granted to undertakings active in the aviation sector falls within the scope of this Regulation. Where a measure does not exceed a total of EUR 200,000 over a period of three years, it will not constitute aid, and thus will not need to be notified to the Commission. It is considered that aid below this threshold should be deemed not to affect trade between Member States and/or not to distort or threaten to distort competition in the EU.

In addition, Regulation 360/2012 sets out the conditions under which compensation under a certain threshold for the provision of an SGEI does not meet all the conditions of Article 107(1) TFEU and accordingly does not constitute State aid. This SGEI-specific de minimis aid may not exceed EUR 500 000 over any period of three fiscal years. This amount is higher than the permitted maximum under the regular de minimis aid regulation.

Both de minimis Regulations shall only apply to aid that is transparent. This means that it must be possible to calculate the exactly the gross grant equivalent of the aid beforehand without the need to undertake a risk assessment.

### b) The General Block Exemption Regulation

The General Block Exemption Regulation (“**GBER**”) applies to various categories of State aid which can be held to be compatible with the internal market in accordance with Articles 107(2) or (3) TFEU. Aid falling within the scope of the GBER shall be exempted from the notification procedure under Article 108(3) TFEU.

Among those categories is social aid for air passenger transport on routes linking an airport in a remote region with another airport. The aid must be for the benefit of the final consumer, and

granted without discrimination. Furthermore, the eligible costs shall be the price of a return ticket from/to the remote region, and the aid intensity can be up to 100% of the eligible costs.

In addition to the specific requirements applicable to social aid for transport, the general conditions contained in Chapter one of the GBER must also be fulfilled. These include, among others, the requirement that the aid is transparent (i.e. it must be possible to calculate the gross grant equivalent of the aid in advance) and that the aid has an incentive effect.

The Commission is currently also reviewing the GBER in order to include an exemption for investment aid to regional airports and ports. A second public consultation on a draft amending Regulation is currently being undertaken.

### c) Aid for the development of certain economic activities or areas

Article 107(3)(c) TFEU is the first of the justifications provided in Article 107 TFEU under which State aid can be held to be compatible with the internal market. It States that “*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*” can be compatible with the internal market.

Generally speaking, aid will be compatible under Article 107(3) (c) TFEU when the following cumulative conditions are met:

- the aid must contribute to a well-defined objective of common interest;
- there is a need for the intervention, i.e. the market cannot deliver a material improvement itself;
- the aid measure must be appropriate to address the objective of common interest;
- the measure must have an incentive effect, which entails that the beneficiary would not have engaged in the additional activity concerned if the aid would not have been granted;
- the aid must be proportionate, i.e. limited to the minimum necessary;
- undue negative effects on competition and trade between Member States must be avoided;
- the aid must be transparent.

The Aviation Guidelines provides a detailed overview how these criteria should be applied to measures directed at airports and airlines, which can be found in Sections 5.1 and 5.2 thereof. A distinction is made between investment aid and operational aid for airlines. Investment aid covers aid intended to finance fixed capital assets, and specifically for covering the capital costs funding gap, whereas operating aid covers operating funding gap.

*i. Investment aid to airports*

In order to be held compatible with the internal market, investment aid to airports will be considered to contribute to the achievement of an objective of common interest by: (a) increasing the mobility of EU citizens and the connectivity of the regions by establishing access points for intra-EU flights, (b) combatting air traffic congestion at major EU hub airports, or (c) facilitating regional developments.

Investment aid must have at least medium-term prospects. For instance, where the investment aims at increasing the capacity of the airport, new infrastructure should meet the anticipated demand in the medium-term.

The need for public funding for the purpose of financing airport infrastructure varies according to the size of the airport due to the high fixed costs. The Commission thus provides an overview of the different categories of airports and their relative financial viability:

- airports with up to 200 000 passengers per annum may not be in a position to cover their capital costs to a large extent;
- airports with between 200 000 and 1 million passengers per annum are usually not able to cover their capital costs to a large extent;
- airports with annual passenger traffic of between 1 and 3 million should on average be able to cover their capital costs to a greater extent;
- airports with annual passenger traffic between 3 and 5 million should in principle be able to cover, to a large extent, all their costs (operating and capital), but may require, under specific circumstances, public support to finance some of their capital costs;
- airports with annual passenger traffic above 5 million are usually profitable and are able to cover all their costs, except in very exceptional circumstances.

The Commission will consider the measures to be appropriate if it can be shown that other policy instruments or forms of State aid have been considered. The Commission encourages the design of framework schemes that ensure coherence in the use of public funds, reduce the administrative burden on smaller granting authorities and accelerate the implementation of individual measures.

In order to establish an incentive effect, it should be verified that the investment project would not have taken place, or at least not to the same extent, where no State aid was granted. In addition, construction works cannot begin before the application for aid has been made.

For investment aid to airports to be proportionate, it should not exceed the extra costs which result from undertaking the aided project (as distinct from the project that would have been undertaken if there was no aid).

The maximum amount of aid that is permitted in order for a measure to be proportionate is expressed as a percentage of the eligible costs (aid intensity). The eligible costs are costs related to the investments in airport infrastructure, including planning costs, ground handling infrastructure, and airport equipment. The permitted aid intensity varies per airport category: 3 to 5 million passengers per annum (25%), between 1 and 3 million (50%), and below 1 million (75%).

Under certain circumstances the permitted aid intensities may vary. For instance, the maximum aid intensity for airports in remote regions (irrespective of their size) may be increased by up to 20%. Also, in exceptional circumstances, depending on the characteristics of the airport involved, the investment project, and the region served, the aid intensity for airports with annual traffic below 1 million passengers may exceed 75%.

To avoid undue negative effects on competition and trade, regard must be had for any existing airports within the catchment area. In addition, the airport, including the investment for which aid was granted, must be open to all potential users in an equal manner.

Finally, the Aviation Guidelines provide guidance on the notification of individual aid and aid schemes, depending on the risk of distortion of competition. The Commission encourages Member States to notify schemes for investment aid for airports with average annual traffic below 3 million passengers. Due to a higher risk of distortion, the following aid measures should always be notified individually:

- investment aid to airports with annual traffic above 3 million passengers;
- investment aid with an aid intensity above 75% to an airport with average annual traffic below 1 million passengers, with the exception of airports located in remote regions;
- investment aid granted for the relocation of airports;
- investment aid financing a mixed passenger/freight airport handling more than 200 000 tonnes of freight during the two financial years preceding that in which the aid is notified;
- investment aid aimed at the creation of a new passenger airport (including the conversion of an existing airfield into a passenger airport);
- investment aid aimed at the creation or development of an airport located within 100 kilometres distance or 60 minutes travelling time by car, bus, train, or high speed train from an existing airport.

#### *ii. Operational aid to airports*

The same common interest objectives apply to the grant of operational aid as apply to the grant of investment aid to airports.

As for investment aid, the need for public funding for the purpose of financing operating costs varies according to the size of the airport and its fixed costs. The Commission thus provides an overview of the different categories of airports and their relative financial viability, which differs from that provided above for investment aid:

- airports with up to 200 000 passengers per annum may not be able to cover their operating costs to a large extent;
- airports with between 200 000 and 700 000 passengers per annum may not be able to cover their operating costs to a substantial extent;
- airports with annual passenger traffic of 700 000 to 1 million should in general be able to cover their operating costs to a greater extent; airports with annual passenger traffic between 1 and 3 million should on average be able to cover the majority of their operating costs;
- airports with annual passenger traffic above 3 million are usually profitable at operating level and should be able to cover their operating costs;
- airports with annual passenger traffic in excess of 3 million are not eligible for operating aid.

A measure will be considered to be appropriate where a Member State can show that the aid is correct means for achieving the intended objective. This will not be the case where less distortive policy instruments or aid instrument would allow for the same result.

Generally, amount of aid should be set in advance as a fixed sum covering the expected operating funding gap during a transitional period of 10 years. This should provide incentive for the efficient management of the airport. A business plan must ensure that at the end of the transitional period, mentioned above, the airport covers its full operating costs.

There will be an incentive effect where it is likely that if no operating aid had been granted, and taking into account the possible presence of investment aid and the level of traffic, the level of economic activity of the airport would be significantly lower.

The maximum aid intensity that is permitted is 50% of the initial funding gap for a period of 10 years. Airports with fewer than 700 000 annual passengers can be subject to a higher aid intensity of 80% over the first five years of the transitional period.

Regard must be had for any existing airports within the catchment area. In addition, the airport must be open to all potential users in an equal manner.

Finally, The Commission urges Member States to notify national aid schemes for operating aid, as opposed to individual grants. However, there are some cases where, due to a higher risk of distortion, the aid measures should always be notified individually including:

- operating aid financing a mixed passenger/freight airport handling more than 200 000 tonnes of freight during the two financial years preceding that in which the aid is notified;
- operating aid to an airport if other airports are located within 100 kilometres or 60 minutes travelling time by car, bus, train, or high-speed train.

*iii. Start-up aid to airlines*

- Start-up aid can be granted to airlines under Article 107(3)(c) TFEU where it:
  - increases the mobility of EU citizens and the connectivity of those regions by opening new routes;
  - facilitates regional development of remote regions.

“Remote regions” under the Aviation Guidelines mean outermost regions, Malta, Cyprus, Ceuta, Mellila, Member State islands, and sparsely populated areas. Aid is not permissible when the new air route is already operated by a high speed rail service or from another airport in the same catchment area under conditions which are comparable.

Start-up aid shall only be compatible for routes linking:

- an airport with less than 3 million passengers per annum to another airport within the Common European Aviation Area (“ECAA”).
- an airport located in a remote region to another airport, within or outside of the ECAA, no matter the size of the airports concerned;
- an airport with between 3 and 5 million passengers per annum which is not located in a remote region, subject to there being a duly substantiated exceptional case;

An airport with more than 5 million passengers per annum not located in a remote region cannot be held compatible with the internal market.

A business plan should be set out in advance which establishes that the route has the prospect of becoming profitable for the airline without any State aid after three years. In case there is no such business plan, the airline must make a commitment to the airport that to operate the route for at the very least the period when it receives aid.

For the aid to be proportional it may cover maximum 50% of airport charges in respect of a routes for a maximum period of three years.

In order to avoid undue negative effects on competition and trade, a Member State must make its plan to grant start-up aid public in good time and with adequate publicity in order to enable all interested airlines to offer their service. Also, it is not possible to combine start-up aid with another type of aid for the purpose of operating a particular route.



Member States are encouraged to notify national schemes for start-up aid to airlines. However, when start-up aid is being granted to an airport not located within a remote region, with an average annual traffic above 3 million passengers, this must be notified individually,

d) The relationship between airports and air carriers when the airport has received State aid

The Aviation Guidelines provide further guidance on the relationship between an airport and an air carrier where the airport has benefitted from compatible or incompatible state aid.

Where the airport operator has benefitted from compatible aid, the advantage will not be considered to be passed on to the air carrier when:

- the infrastructure is open to all air carriers and not dedicated to a specific air carrier; and
- the air carriers pays tariffs covering at least the incremental cost.

However, under these conditions, even if there is state aid for the air carrier, the aid will be compatible with the internal market for the same reasons that it was compatible for the airport.

Where an airport operator has received incompatible investment aid, the advantage will also not be considered to be passed on to the air carrier if the same two conditions above exist. However, under these conditions a sectoral advantage to the air carrier industry or other users cannot be excluded, but should not lead to recovery from specific air carriers or other users.

e) Regional aid

Pursuant to Article 107(3) (a) and (c) TFEU State aid granted by Member States for the purpose of promoting the economic development of certain disadvantaged areas within the EU can be compatible with the internal market. The Guidelines on regional State aid for 2014-2020 (“Regional Aid Guidelines”) govern which sectors and areas are eligible for regional aid, and the intensity of regional aid that is permitted.

It is important to note that the Regional Aid Guidelines do not apply to State aid in the transport sector (including transport of passengers by air) and aid granted to airports is also excluded from the scope of the Regional Aid Guidelines. Therefore Regional Aid Guidelines can be of no practical use for the purpose of improving connectivity through air transport.

f) Social aid

Aid can be justified based on its social character, as provided under Article 107(2) (a) TFEU. This category of aid requires the measure to only cover certain categories of passengers travelling on a route (e.g. people with low incomes). Where the route links remote regions, such as outermost regions, islands, and sparsely populated areas, the aid could cover the entire population of that region. For instance, the Commission has held a discount scheme for eligible air services for people resident in the most peripheral parts of the Scottish Highlands and Islands to be compatible under Article 107(2) (a) TFEU.

Furthermore, to be compatible with the internal market the aid must effectively be for the final consumer, and granted on a non-discriminatory basis with respect to the origin of the services.

The latter of these requirements in practice means that Member States cannot treat different airlines providing the service in a different manner.

## 10. Suggested Legal improvements of the PSO legislation

### *i. The proposal*

As described above that the current EU PSO legislation is too restrictive to be used effectively for the purpose of improving the air connectivity of Estonia.

Although Regulation 1008/2008 does not expressly prohibit the possibility of imposing a single PSO on a network of routes, this might be implied by references to “the route” rather than a group of routes. Furthermore, the draft Guidelines on PSOs provide expressly that routes cannot be bundled in such a way as to make the access to one particular route dependent upon the service of other routes.

Furthermore, under Article 16(10) of Regulation 1008/2008 a group of PSO routes can only be tendered under a single tender to one carrier for reasons of operational efficiency. The draft Guidelines on PSOs furthermore hold that using a single tender for multiple PSO routes is prohibited if it only serves to group profitable and unprofitable routes.

Under this restrictive framework, it is difficult for a Member State to finance the operation of multiple routes in a coordinated manner even if such an approach is necessary to improve the overall air connectivity of a Member State.

It is clear that peripheral countries in the EU are experiencing the same issues with regard to air connectivity, and thus a specific and coordinated approach under the PSO legislation by these countries would be desirable.

Permitting the bundling of multiple routes to form a network would address the needs of these peripheral States.

It is not the purpose of this study to undertake a route-specific profitability analysis. It should be noted however, that the definition of route profitability has been modified by airlines in the wake of the success of the low cost carrier business model. A decade ago, a network carrier would maintain unprofitable routes as long as these contributed to the profitability of the entire network. Total network profitability was the key, not necessarily individual route profitability. The cost allocation per route has now been modified so that each route must show profitability as if it were a standalone route.

This commercial reasoning is the appropriate response to the market success of low cost carriers, but decreases the likelihood of market presence of any airline on unprofitable, i.e. thin, peripheral routes. Peripheral states thus find themselves in a similar situation of having to secure not only services inbound through marketing measures, but also ensure that the business sector outbound can be served with reliable all year services to key destinations on routes which are not served by airlines given their lack of profitability.

Multiple routes would, under the current PSO legislation, indeed constitute an excessive restriction to the access of the routes, because due to the exclusive nature of PSOs, only air carriers with regional bases are likely to be able to provide services on all those routes. Therefore, for the purpose of a PSO for a network of routes, it would be essential not to limit the right to operate the bundle or routes to only one operator, but to permit competitors to operate on individual routes covered by the PSO if they so choose for commercial reasons. Thus the affected Member States could, in the context of a modified regulatory framework, offer routes currently not served reliably in an inclusive tender without underlining competition.

*ii. Means to achieve this*

There are two approaches by which the above-described proposal can be achieved:

- The draft Guidelines on PSOs, which are yet to be finalised and published, could be altered; or
- Regulation 1008/2008 could be amended.

It must be reiterated here that the Guidelines on PSOs are only a draft, and thus the final version that is adopted may differ from the version to which we have had access. Therefore it is possible that the section regarding multiple routes under a single PSO may differ in the final version.

If the Commission publishes the Guidelines in accordance with the Aviation Strategy before the end of 2016, then there will be insufficient time for them to be influenced. However, even when the Guidelines have been adopted, they can still be altered in the future, although this will likely be more onerous.

Although guidelines generally are only of an interpretive nature, and do not have legally binding force, the Commission will generally not deviate from guidelines it has produced. Furthermore, it is not the EU legislation but the draft Guidelines that *expressly* prohibit bundling of routes under a PSO. Therefore changing the guidelines to allow for the above-described network PSO for peripheral States could prove to be effective.

Even more effective, however, would be amending Regulation 1008/2008 to *expressly* allow for a network of routes to be bundled under a single PSO if the Member State finds that key routes which it considers to be essential for a viable economic development are not served on an all-year basis. Such an amendment will be legally binding, rather than merely interpretative, and therefore is a stronger option.

In accordance with Article 100(2) TFEU, the ordinary legislative procedure (Article 194 TFEU) is to be used for the adoption of legislation in the air transport sector. Under this procedure, a legislative proposal would need to be submitted to the European Parliament and Council by the Commission.

*iii. Summary*

- The current PSO legislation is too restrictive to be used by Member States to improve their air connectivity.

- Changes could be made to allow peripheral States to bundle a network of profitable and unprofitable routes under a single PSO.
- To avoid excessively restricting competition, the right to operate the routes contained within the network will not be exclusively restricted to the PSO operator.
- This could be achieved by amending the PSO Guidelines, either before or after they have been adopted.
- However, a stronger option would be to amend Regulation 1008/2008, although this will require a more rigorous legislative procedure to be followed, involving different EU institutions.

## 11. Analysis of improvement of the current legal framework on state aid

### *i. The proposal*

As argued above, establishing a network of profitable and unprofitable routes would be an efficient way for peripheral States to improve their air connectivity. As an alternative to improving the PSO legislation, adjustments could also be made to the application of the existing State aid legislation.

The most appropriate way would be to allow Member States to set up and remunerate the operation of a network of routes by justifying this under Article 107(3)(c) TFEU. This way remunerating an air carrier for the operation of the network of routes will constitute state aid, and thus need to be notified to the Commission, but will be compatible with the internal market.

The provision of such state aid for connectivity will be exclusively available for peripheral states faced with inadequate air connectivity. It is important to distinguish this from start-up aid that is described under the current Aviation Guidelines. Start-up aid to air carriers for setting up new routes is intended as a “kick-start” for setting up new routes and must therefore be phased out over time. Eventually the operation of the routes must become profitable so that they can be operated without State aid. However, many routes to/from peripheral States have no prospect of becoming economically viable in the long-run, even after receiving start-up aid.

As has been explained above, in order for State aid for connectivity to be held compatible under Article 107(3)(c) TFEU it would need to fulfil seven cumulative conditions:

- The aid must contribute to a well-defined objective of common interest;
- There is a need for the intervention;
- The aid measure must be appropriate to address the objective of common interest;
- The measure must have an incentive effect;
- The aid must be proportionate, i.e. limited to the minimum necessary;
- Undue negative effects on competition and trade between Member States must be avoided;

- The aid must be transparent.

The Commission could potentially consider State aid for the operation of a network of routes to contribute to a well-defined objective of common interest where the air connectivity in peripheral Member States is improved. Indeed, the Aviation Guidelines similarly hold that start-up aid for air carriers can contribute to a well-defined objective of common interest where it increases the connectivity of the regions, or facilitates regional development.

Regarding the need for the intervention, practice has demonstrated a clear market failure in the aviation sector in peripheral areas where many routes do not provide sufficient economic incentives for air carriers to operate them.

With regard to the appropriateness of the aid, it should, for instance, be demonstrated that start-up aid for air carriers for opening up new routes will not resolve the connectivity problem on the long-run. In peripheral States this should not constitute an obstacle as many routes will not have the prospect of becoming profitable after the start-up aid has been phased out.

In order to ensure the proportionality of the aid, the Commission may find it necessary to set a maximum aid intensity.

To avoid an excessive restriction to the access of the routes, and thus a restriction on competition, operation of the routes contained within the network should not be limited exclusively to the aid recipient. Also, attention must be had for existing alternative methods of transportation, such as high-speed trains, operating one or more of the routes in question, or neighbouring airports through which the traffic is already flowing. Finally, plans to provide aid for the operation of the network should be made public in good time and with adequate publicity in order to enable all interested airlines to offer their services. It will likely be required to hold a public tender to award the operation of the network.

#### *ii. Means to achieve this*

The State aid for connectivity could either be granted directly by the State to the air carriers, or alternatively passed on through an airport to the air carriers. The most straight forward approach would be the former. However, some States may find an airport to be better suited to provide this State aid. In this case, however, the airport would need to be invested with a public interest task of improving the air connectivity of the State.

The above-described proposal could potentially be adopted without prior legal revision. Article 107(3)(c) TFEU constitutes the legal basis for the justification and can be directly relied on. This can be tried, but it is a new and untested approach. As the measure will constitute State aid, it will need to be notified to the Commission under Article 108(3) TFEU. The measure cannot be implemented until the Commission has cleared it.

To create more legal certainty, however, the Commission can be approached to provide guidance in the Aviation Guidelines as to the conditions under which funding the operation of a network of routes would be cleared under Article 107(3)(c) TFEU. As has been seen above, such guidance is provided in the Aviation Guidelines for the clearance of operational and investment aid for airports, and start-up aid for airlines under Article 107(3)(c) TFEU.

As noted above, Commission guidelines are not legally binding. However, the Commission will act in accordance with them.

The Aviation Guidelines are in the form of a Commission Communication. Thus, any amendment will go through the internal decision making process of the Commission, without recourse to other EU institutions, as required under the ordinary legislative procedure elaborated on above. Therefore, justification of State aid for connectivity under Article 107(3)(c) TFEU could be an alternative way to overcome the limitations of the PSO legislation without needing legal revision.

### *iii. Summary*

- State aid for operating a network of routes for the purpose of improving the air connectivity of peripheral Member States could potentially be held compatible with the internal market under Article 107(3)(c) TFEU.
- Such State aid for connectivity will need to be notified to the Commission and cleared before it can be granted.
- This justification could be invoked directly on the basis of Article 107(3)(c) TFEU.
- However in order to improve legal certainty the Commission could be approached to provide guidance in the Aviation Guidelines.

## **12. Improving the legislation enabling the provision of other measures**

It is our understanding that the government intends to pursue a policy of enhancing connectivity so that the Estonian business traveller can benefit from reliable and viable all-year connections to key destinations, it being understood that such connections would, over time, draw interest from other passengers to/from Estonia and possibly attract passengers which, in the absence of an optimal option, are travelling via neighbouring hubs.

Such a policy to enhance connectivity faces restrictions, as outlined in our legal assessment above, which can be overcome if appropriate changes to the regulatory framework are implemented.

Other measures which improve the viability of the operations for the airline, and therefore increase the likelihood that services will be offered even without government incentives such as PSOs, have been reviewed above. In our analysis of “other measures“, we distinguished – setting aside the re-negotiation of traffic rights as a possibility - between a generic description of measures undertaken by airports and airlines, specific publicly known measures offered by airports on their websites and cases decided upon by the EU Commission. We have also discussed the measures undertaken by Tallinn airport<sup>54</sup>.

The legal analysis reveals an established procedure for the evaluation of such measures by the Commission; in fact, over time, a case law has been established on the limits of state aids and the

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<sup>54</sup> Tallinn airport provided us with an overview of their offers to airlines, and discussed a specific offer for the route to London.

circumstances under which measures undertaken by government-owned airports are considered to be state aids. The basic principle of the Commission's policy is to ensure that unnecessary public funding is limited and competition is enhanced.

We submit that a solid case can be developed to substantiate the proposal to facilitate PSOs if connectivity could otherwise not be ensured given the weak market. However, a proposal to facilitate state aids by governments of peripheral Member States to airlines either directly or via publicly-owned airports to promote traffic, is highly unlikely to find political support and will be difficult to justify legally. All airlines and airports are subjected to framework legislation and operate under market conditions, or are treated "as if" they were market operators. If the market is too thin to warrant a direct service then the demand will flow via indirect routes – absent a PSO; this does not preclude an airport from providing incentives, if these incentives are considered to be commercially reasonable. But there is no justification for a state aid to a state-owned airport of a peripheral state to grant incentives which are devoid of commercial reasoning.

We suggest, therefore, that the legal framework for other measures is currently robust; seeking to change it would open a Pandora's box jeopardizing fundamental principles of EU aviation policy.

### **13. Improvement of the operating environment in peripheral areas**

Notwithstanding the above, we do believe that "round table" initiatives by the government could be the basis for a better public appreciation of the role aviation plays for the national economy. As mentioned above, aviation players in the wider sense, namely the Tourism Council, Business Organisations, communities in the vicinity of Tallinn airport, industrial sectors which benefit the most from aviation, as well as the airport, aviation service providers and unions, should be convened to discussions about the effect of a coherent future-oriented aviation policy for the Estonian economy. The objective of such a Round Table is to sensitise private bodies and corporations to provide incentives for the growth of aviation, offer to commit to volume commitments for airlines that address their preferred option of flying direct and even create funds to finance marketing agreements of the airport without involving state-owned entities.

We furthermore encourage the government to initiate informal meetings of the DGCA's of peripheral Member States. (In 2014, the Polish DGCA convened a workshop of DGCA's of CESE Member States during which the EU Commission delivered a presentation on the importance of connectivity for Member States. Such an initiative is exemplary.) These meetings strengthen the notion of common interests and could lead to joint political activities.<sup>55</sup>

### **14. Possible strategic steps to consider when implementing recommendations**

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<sup>55</sup> Although not entirely comparable, the 5 Northern "Bundesländer" of Germany held such meetings and developed an aviation policy paper for these regions.

Our study identifies the difficulties facing Estonia when developing a viable aviation policy, describes further measures currently applied in other countries to stimulate demand, and identifies modifications to the current regulatory framework which would facilitate the introduction of PSOs on routes considered to be of vital importance for the air connectivity to/from Estonia.

In our view, Estonia has a strong case to substantiate the conclusions of this study. Although the domestic market is relatively small, the growth of the economy is curtailed by the limited availability of reliable air services for the business traveller. The market to/from Estonia in turn is limited because of the distance to be overcome to reach the relatively small Estonian market.

However, in order to avoid a “pro domo” discussion in Brussels, we strongly recommend considering an approach which includes other peripheral Member States in a similar situation to that of Estonia. All are confronted with the same issue of having to secure reliable all year services in the knowledge that large low cost carriers can, at any time, penetrate any of the peripheral markets - and abandon them - when this meets their commercial requirements.

If all peripheral small Member States were to propose legislative changes which would facilitate connectivity to/from their respective markets, the political impact would be significantly different. The political discussion would then not be about one Member State seeking to resolve a national problem, but about the need for the Commission to address a structural issue facing the European Union. The proposals contained in this study would then not be perceived as a “problem” addressed by a Member State, but as a solution for consideration by the Commission.

Experience shows that such joint initiatives are best prepared on the basis of a workshop of experts from the respective Member States; once these have agreed on the required steps, further meetings with Commission experts, and ultimately a proposal can be developed quite rapidly. Ideally, steps to implement the suggested measures should be envisaged before the Estonian EU Presidency.

Should such an “implementation plan” be considered useful, we would be happy to assist in facilitating it, and securing its ultimate successful outcome.



## APPENDIX 1

### INDICATIVE COSTS FOR OPERATING 1xE170 ON PROPOSED ROUTES:

	London	Amsterdam	Brussels	Vienna	Zurich	TOTAL
<b>Variable costs (€)</b>						
Fuel Cost	3 773	3 188	3 424	2 945	3 617	
Eurocontrol	2 386	1 934	2 055	1 762	2 195	
Airport Charges	588	588	592	588	588	
Ground Handling	1 697	1 101	1 714	1 697	1 697	
De-icing	317	289	324	317	317	
Maintenance reserves	2 620	2 292	2 501	2 145	2 531	
CO2 charges	144	122	131	113	138	
Crew related direct costs	95	80	86	74	91	
<b>Fixed costs (€)</b>						
Crew	1 959	1 656	1 779	1 530	1 879	
Aircraft (including insurance and MTX cover)	4 029	3 405	3 657	3 146	3 863	
Management fee	3 488	2 948	3 166	2 723	3 345	
<b>Profit margin for operator</b>	<b>1 055</b>	<b>880</b>	<b>971</b>	<b>852</b>	<b>1 013</b>	
<b>TOTAL COST PER ROUND TRIP (€)</b>	<b>22 151</b>	<b>18 483</b>	<b>20 400</b>	<b>17 893</b>	<b>21 274</b>	
<b>TOTAL COST PER SEAT PER ROUND TRIP (€)</b>	<b>291</b>	<b>243</b>	<b>268</b>	<b>235</b>	<b>280</b>	
<b>TOTAL COST PER ROUTE PER MONTH (€)</b>	<b>191 973</b>	<b>160 186</b>	<b>176 799</b>	<b>155 071</b>	<b>184 377</b>	<b>868 405</b>

\*This excludes catering cost, passenger taxes and APD. Catering cost, passenger taxes and APD can be roughly estimated at €9,7m per aircraft.

### THE UNDERLYING ASSUMPTIONS IN THIS SIMPLIFIED MODEL ARE AS FOLLOWS:

- 1 E170 aircraft flying twice daily to the destination airport
- The destination is different each day (London, Amsterdam, Brussels, Vienna, Zurich), so effectively the schedule is a 'synopsis' representing an equal mix of the five routes
- There is no flying at weekends – we have also assumed the aircraft can be parked free of charge at TLL during weekends. In a more developed business plane one would seek midday and weekend opportunities.
- We have shown the approximate full cost of flying for a one aircraft programme, and in order to achieve this type of pricing,
- We would expect that the Government of Estonia would have to enter a minimum one year, and possibly up to three-year contract.
- We have used previous data relating back to April 13 for the AMS and BRU routes and then estimated the costs for the other routes based on our knowledge of relative pricing, and also adjusted for block hours.
- We have escalated costs to 2017 levels and also adjusted for both fuel and foreign exchange to use current rates.
- The resultant monthly cost is €868k, or annual cost of €10,420k based on the assumed utilisation.
- Changes to utilisation will result in changes to total cost – we can model such changes if required.
- Catering costs, passenger taxes and APD are all excluded.
- There is no marketing, sales and distribution cost included for selling seats.
- Local crew are assumed – if this was an ACMI / subcharter operation there would also be away from base costs that could be payable to crew.
- If this is considered a long term opportunity, it will be important to identify local pilots and cabin crew.
- The seat cost per round trip is based off 76 seats in the E170 and assumes a 100% load factor.

With regard to the instructions, we assumed that the Government was looking for a five aircraft fleet flying to each destination daily.

**In summary, excluding Hamburg and Goteborg flying, we would expect that one aircraft will cost €12.4m and five aircraft €62m per annum, including APD, catering and Crew Away from Base costs.**

For this number of aircraft, it is likely that this would have to be a longer term agreement.

**THIS IS A SIMPLISTIC APPROACH. THE NUMBERS AND ASSUMPTIONS ARE ONLY MEANT TO GIVE AN ILLUSTRATION OF THE SCALE OF FUNDS ASSOCIATED WITH OPERATING THE AIRLINE AS DESCRIBED.**