

## COMMISSION DECISION

of 7 March 2007

## State aid C 10/06 (ex N555/05) — Cyprus Airways Public Ltd — Restructuring plan

(notified under document number C (2007) 300)

(Only the Greek version is authentic)

(Text with EEA relevance)

(2008/137/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provision(s) cited above <sup>(1)</sup>,

Whereas:

#### I. PROCEDURE

- (1) On 3 May 2005 the Commission decided to authorise rescue aid (N69/2005) for Cyprus Airways Public Ltd. (Decision 2005/1322).
- (2) By undated letter registered by the Commission on 9 November 2005 (DG TREN A/28405) in accordance with Article 88(3) and with undertakings given in the context of the notified rescue aid referred to above, the Cypriot authorities notified the Commission of a restructuring plan for Cyprus Airways Public Ltd. On 14 November 2005 the Secretariat General of the Commission registered the notification under reference SG(05)A10041 and the case was given the number N 555/2005.
- (3) On 18 November 2005 (D(05)125084) the Commission asked the Cypriot authorities for additional clarifying information. The Cypriot authorities answered the Commission's questions by letter dated 23 January 2006, registered on 24 January 2006 (under reference DG TREN A/11819). On 14 December 2005 a meeting took place in Brussels between representatives of the Republic of Cyprus and the Commission. A subsequent high-level meeting took place on 30 January 2006 in Brussels to discuss progress on the case.
- (4) By decision of 22 March 2006, notified to the Cypriot authorities by letter dated 23 March 2006 (SG-Greffe (2006) D/201246), the Commission initiated the procedure laid down in Article 88(2) of the Treaty. The procedure has been registered under C 10/2004.

- (5) The Commission decision to initiate the formal investigation procedure was also published in the *Official Journal of the European Union* <sup>(2)</sup>. The Commission invited interested parties to submit their comments on the subject. Cyprus forwarded comments to the Commission by letter dated 20 April 2006.

- (6) Within the timeframe provided for in the published opening of procedure, the Commission received one comment from interested parties. This comment was then submitted to the Cypriot authorities (D(2006) 213376) for their observations and the observations of Cyprus were received on 28 July 2006 (registered on 1 August 2006 under reference A/28810). Further clarifications were received from the Cypriot authorities by fax dated 19 December 2006 (registered on 31 December 2006 under reference A/40766). Further clarifications and commitments were received by fax on 28 February 2007.

#### II. THE FACTS

- (7) Cyprus Airways Public Ltd. was established in 1947 as a public company, its principal activities are the transportation by air of passengers and cargo and other airline related services. The main shareholder of the company is the Cyprus government (69,62 %) while the balance of the shares is held by some 4,200 small private investors.
- (8) Cyprus Airways Public Ltd. (hereinafter Cyprus Airways) is part of the Cyprus Airways group (hereinafter the Group).
- (9) Cyprus Airways currently provides scheduled services in Europe and the Middle East operating a fleet of 11 aircraft, two A319 delivered in 2002 owned by Cyprus Airways; seven A320-200s delivered between May 1989 and March 1993; owned by Cyprus Airways; one aircraft of which was previously wet-leased to Eurocypria and two A330-200, delivered in 2002 & 2003 (leased).

<sup>(1)</sup> OJ C 113, 13.5.2006, p. 2.

<sup>(2)</sup> Cf footnote 1.

- (10) At the time of notification of the restructuring plan the other companies within the Group, all 100 % owned by Cyprus Airways Public Ltd were:

*The long-term loan of CYP55 million (€96 million) and cost cutting measures*

#### Eurocypria Airlines

- (11) This company (hereinafter Eurocypria) operates charter flights from over fifty European airports, Eurocypria's fleet is composed of five aircraft, four leased Boeing 737-800, acquired between February and April 2003 each with a capacity of 189 passengers as well as an A320 aircraft (A320) on 'wet lease' from Cyprus Airways.

- (16) The central plank of the restructuring plan is a loan on commercial terms with a guarantee from the Cyprus government for a ten year period, and will in the first case be used to repay the short-term loan of CYP 30 million (EUR 51 million) made following the rescue aid approval in May 2005. Thereafter the balance will be used to restructure the airline.

#### Hellas Jet SA

- (12) Hellas Jet SA (hereinafter HellasJet) was incorporated in Athens on 1 July 2002 beginning operations on 24 June 2004. Hellas Jet was conceived as a new Athens-based European airline. It operated three leased Airbus A320s based at Athens International Airport. However, business plans were not met and scheduled operations were suspended as of May 2005. The results of this venture were therefore financially damaging, costing the Group an accumulated amount of CYP 29,5 million (EUR 51,4 million) as of June 2005.

- (17) In the first 24 months of the restructuring plan the main focus was to be on cost cutting and selected revenue enhancement. The government and management estimated that total costs needed to be reduced by 13 %. This was to be achieved by cutting staff numbers by some 20 % and at the same time reducing salary levels by an average of 15 %. This means that of a staff of 1 840 as of 1 September 2005, 385 were to be made redundant under the restructuring plan; these redundancies were to lead to annual savings of approximately CYP 7 million (EUR 12 million); further economies of some CYP 4,6 million (EUR 8 million) will be cut from ongoing staff costs.

#### Zenon National Distribution Centre Ltd.

- (13) This subsidiary company (hereinafter Zenon) provides services to Cypriot travel agents. Specifically, Zenon provides and distributes electronic information that allows travel agents to make air seat reservations and ticketing as well as hotel and car reservations.

- (18) The Commission expressed doubts regarding whether the plan would restore the long-term viability of the company in the shortest possible time and without need for additional aid in the future. It also stated that it did not have enough information to be able to take a position on whether the amount of the aid element of the restructuring plan has been kept to a minimum. The Commission also questioned the need for the long-term loan to be paid off over 10 years. The Commission said that it did not have enough information to be able to say if the financial projections are reasonable or if the assumptions on which these are based are valid and it would be particularly interested in having the opinion of Cyprus Airways' competitors on the plan.

#### Cyprus Airways (Duty Free Shops) Ltd.

- (14) This company commenced its operations in 1996 when it took over the operation of the Duty Free Shops in Larnaca and Paphos airports. At the time of notification of the restructuring plan it was intended that the Duty Free Shops at Larnaca and Paphos airports will be taken over by the new airport concessionaire and no longer form part of the Group. This happened in June 2006.

#### *Sale of Eurocypria*

- (19) The restructuring plan envisaged the sale of Eurocypria, the charter subsidiary of Cyprus Airways to the government at a price to be determined by an independent expert. The price was initially estimated at CYP 15 million (EUR 26 million). Eurocypria would therefore be separated from the Cyprus Airways group and operated as a completely distinct entity. The proceeds of the sale (paid by the government to Cyprus Airways) would be used by the latter to fund its restructuring. The Commission expressed doubts regarding the sale and how the sales price would be arrived at. If the price paid for Eurocypria were not to be a market price then it would be State aid.

### III. THE OPENING OF PROCEDURE

- (15) The decision of the Commission to open the procedure provided for under Article 88(2) was based on a number of issues arising from its examination of the restructuring plan. The Commission expressed doubts as to whether the plan was compatible with the applicable community framework, i.e. the Community guidelines for the State aid for the Rescue and Restructuring of Firms in Difficulty of 2004 <sup>(3)</sup> (hereinafter the R & R guidelines).

<sup>(3)</sup> OJ C 244 1.10.2004 p. 2.

*Capital increase*

- (20) A further part of the restructuring plan, intended to take place 18 months after the plan has been initiated is a capital increase of CYP 14 million (EUR 24 million). All shareholders (State and private shareholders) will participate in proportion to their shareholding. The State will put up CYP 9,8 million (EUR 17 million) while the private shareholders' contribution in this capital increase will be around CYP 4,2 million (EUR 7,3 million). In opening the procedure the Commission indicated that it could not exclude that the State participation in this capital increase could amount to State aid.

*Compensatory measures*

- (21) The Commission expressed doubts as to whether the compensatory measures proposed in the restructuring plan would be sufficient to remedy the market distortion caused by the aid. The plan included relatively small reductions in the fleet and route network for Cyprus Airways. The charter arm Eurocypria was to be sold off and another subsidiary HellasJet was to be closed down and its three aircraft released. The Commission expressed doubts in particular as Eurocypria was to be sold to Cyprus Airways' principal shareholder. The Commission invited comment from Cyprus Airways' competitors in this regard.

*Own contribution*

- (22) Normally with a company of the size of Cyprus Airways the level of own contribution to the restructuring costs should be in the order of 50 %. The Commission expressed doubts regarding the level of own contribution and as to what should be considered as constituting an own contribution.

**IV. COMMENTS RECEIVED DURING THE PROCEDURE****Initial comments of the Cypriot authorities**

- (23) The Cypriot authorities replied to the opening of procedure by seeking to clarify certain issues raised by the Commission.

*The long-term loan of CYP55 million (€96 million) and cost cutting measures*

- (24) In relation to the issues concerning the restoration of long-term viability of Cyprus Airways, the restructuring plan provided that the restructuring costs (financed by the long term loan of CYP 55 million as well as the proceeds of the sale of Eurocypria) were to be spent as follows

Period	Sum (CYP million)	Description
2006	30	Repayment of rescue aid
2006	10,6	Redundancy payments
2006	2	Other redundancy costs
2006-2008	5	Working capital for Cyprus Airways
2006-2008	13,5	Predicted capital expenditure
2006-2010	10	Cash flow deficits
<b>Total</b>	<b>71,1</b>	

- (25) In relation to the future operation of the company, both the Cypriot authorities and the airline have acknowledged that the strategic and operational model that served Cyprus Airways in the past is not sustainable in the competitive environment where the company operates today. The basic misalignment lies in the fact that Cyprus Airways operates at a cost level of a fully fledged network carrier while the reality of the liberalized leisure-dominated Cyprus market only allows for revenue levels which are at par with those of charter and/or low cost airlines, which are in fact Cyprus Airways' real competitors.

- (26) In the current business environment and given the full liberalisation of the air transport market in Cyprus, Cyprus Airways has only limited options for further growth or revenue enhancement. Even the predicted growth in the aviation market of over 4 % would not allow Cyprus Airways to get out of its current difficult situation without additional action. Therefore the company has undertaken a hard restructuring in which drastic cost cutting is unavoidable.

- (27) In the restructuring plan the company had estimated that total costs need to be reduced by 13 %. This was to be achieved by cutting staff costs by around 20 % and at the same time reducing salary levels on average by 15 %.

- (28) In addition to this cost cutting the company has to undertake other elements of the restructuring plan which is ongoing and which argues at this early stage for the long term viability of the company. It is now intended that the company will be in a position to successfully reposition itself in a manner that would allow the airline to survive and create an acceptable Return on Investment (ROI) in the medium term, without any further subsidy or aid. It is intended that during 2007 that a second round of cost cutting will be undertaken, focusing on outsourcing and industry best practice.

**Profit and loss evolution Cyprus Airways (forecast) (\*)**

CYP 000s

	2004	2005	2006	2007	2008	2009	2010
Total revenues	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Total costs	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Operating Result	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Profit (loss) before tax	[...]	[...]	[...]	[...]	[...]	[...]	[...]

- (29) The future turnaround of the airline is based on consolidating the benefits accruing from these reduced costs and steadily growing the airline. In this respect the restructuring plan foresees passenger traffic evolution for the period 2004-2010 as follows

**Cyprus Airways Passenger Traffic evolution (forecast) (\*)**

	2004	2005	2006	2007	2008	2009	2010
Overall Cyprus traffic (millions)	[...]	[...]	[...]	[...]	[...]	[...]	[...]
CY traffic (millions)	[...]	[...]	[...]	[...]	[...]	[...]	[...]
CY market shares	[...]	[...]	[...]	[...]	[...]	[...]	[...]

*Sale of Eurocypria*

- (30) In relation to the sale of Eurocypria, the government clarified that in addition to the evaluation previously carried out by PricewaterhouseCoopers on behalf of Cyprus Airways to establish a market price for Eurocypria a second valuation on behalf of the government had been commissioned from HSBC to determine a sales price under well established and accepted methodology. The sale of Eurocypria to the State would therefore be carried out at arms length.
- (31) PwC have carried out a valuation of the company using the Discounted Cash Flow (DCF) methodology and comparing the implied valuation multiples to the market approach they have also taken into consideration transactions involving the purchase and sale of comparable companies in the industry.
- (32) PwC report that the revenue of the company is derived from the sale of aircraft seats to tour operators, the total of passengers carried in 2005 amounted to 662 561 and this is expected to increase to 829 092 during 2006, it should be noted that the forecasted revenue for 2006 has already been contracted. The major components of operating costs for 2005 were aviation fuel (30 %) aircraft lease rentals (22 %) airport and en-route costs (15 %) crew costs (11,5 %) and maintenance/engineering costs (9,5 %).

(\*) Business secret.

## Key performance indicators

	2004 <sup>(1)</sup>	2005 <sup>(2)</sup> M	2006 <sup>(3)</sup> E	2007 E	2008 E	2009 E
Total flights operated	[...] (*)	[...]	[...]	[...]	[...]	[...]
Passengers carried	[...]	[...]	[...]	[...]	[...]	[...]
Total income (CYP 000s)	[...]	[...]	[...]	[...]	[...]	[...]
Gross profit (CYP 000s)	[...]	[...]	[...]	[...]	[...]	[...]
Operating profit (loss) (CYP 000s)	[...]	[...]	[...]	[...]	[...]	[...]
Profit (loss) before taxation (CYP 000s)	[...]	[...]	[...]	[...]	[...]	[...]

<sup>(1)</sup> Audited financial statements.

<sup>(2)</sup> M = management accounts, not yet audited.

<sup>(3)</sup> E = Estimated.

(\*) Business secret.

- (33) For the financial year 2005 Eurocyprria anticipated a profit in the region of CYP 440,000 this amounts to a drop in performance compared to previous years and to the projected figures due to a steep increase in fuel prices experienced in 2005 which could not be passed on to passengers due to the nature of the agreements with tour operators.
- (34) The DCF method gives an indication of the value of a business based on the value of the free cash flows that the business can be expected to generate in the future, it is designed to find the present day value of future cash flows arising to investors, the resulting cash flows must be discounted at the required rate of return to arrive at an estimate for the present value of the business.
- (35) Four year (2006-2009) financial projections were prepared by the management of Eurocyprria, these provided for a 'terminal value' of the company representing the amount that an investor would pay today for the rights to the cash flows of the business for years subsequent to the four year projection. A terminal value of CYP 14,54 million was arrived at; this was then discounted by a 'weighted average cost of capital' of 9,35 % to arrive at a 'net present value' of the company of CYP 14,21 million.
- (36) This net present value was then subject to a number of sensitivity analyses to take account of possible varying parameters such as differing USD/CYP exchange rates, (many of the company's costs are in US dollars while its earnings are in other currencies) differing growth prognostics and differing fuel prices. The sensitivity analyses highlighted the high sensitivity of Eurocyprria (in common with most Community airlines) to fluctuations in exchange rates and fuel prices.
- (37) On the basis of the analysis described above PwC arrived at an indicative range of values for Eurocyprria of between CYP 12,5 million to CYP 16 million.
- (38) PwC have also carried out a market comparable analysis of the value comparing Eurocyprria with other companies in similar lines or similar types of business. This is considered as a valid additional comparison method as the conditions and prospects of similar businesses depend on common factors such as overall demand for their products and services as well as cost structure and operating environments.
- (39) Owing to the lack of publicly quoted charter airline companies PwC used a mix of low cost carriers and mixed scheduled and charter carriers. A calculation made on the basis of the current and projected earnings before interest, tax, depreciation and amortization (EBITDA) led to an indicative value of the company's equity of between CYP 12,5 and CYP 13,5 million. PwC note that this result converges towards the result of the DCF methodology.
- (40) PwC have also carried out a third and final valuation of Eurocyprria based on recent transactions, in their view this applies a reasonableness test to the two previously mentioned methodologies. The theory behind this approach is that the price achieved at arm's length between a willing buyer and a willing seller is a good indicator of value. PwC have made use of data available to their global network and have come up with an indicate value using this method of approximately CYP 10,5 to CYP 13 million for Eurocyprria. PwC point out that this result also converges towards the result of the DCF methodology.

- (41) Accordingly and on the basis of the analyses mentioned above, PwC reach the conclusion that the indicative value for Eurocyprria in the range CYP 12,5 to CYP 15,5 million.
- (42) PwC also add that their valuation of the Eurocyprria is based on financial projections for the company where Eurocyprria would retain some type of affiliation with Cyprus Airways. According to PwC, such an affiliation would give rise to certain hindrances to expansion most notably; restrictions on growth due to the fact that Eurocyprria is a subsidiary of Cyprus Airways; Eurocyprria's status as a subsidiary of Cyprus Airways limits its possibilities to achieve competitive pricing with respect to outsourcing of services. If Eurocyprria were to stay part of the Group it is also likely that it could not compete on the same routes with Cyprus Airways.
- (43) On this basis PwC conclude that the price for Eurocyprria as a separate entity free of these restraints could probably be higher.
- (44) A second evaluation has been carried out by HSBC. HSBC have adopted a similar approach to that carried out by PwC. Their initial conclusion is that Eurocyprria has a total equity value of CYP13 million. HSBC have then carried out a comparative value assessment looking at publicly quoted companies which are comparable to Eurocyprria, in so doing they have arrived at a valuation of CYP 11,8 for Eurocyprria.
- (45) HSBC refer to the sensitivity of the company in particular to variations in fuel pricing and arrive at a weighted average value of the company in the range of CYP 12,3 to CYP 13,8 million.

#### *Capital increase*

- (46) With regard to the capital increase, this would be designed to address the negative net worth arising from accumulated past losses which have eroded Cyprus Airway's equity. The equity increase will be made by way of a rights issue which will be offered pro-rata to the shareholders with 70 % being offered to the State and 30 % to the private shareholders. In the opinion of the Cyprus government this equity increase will be an investment similar to that made by a market economy investor.

#### *Compensatory measures*

- (47) On the issue of compensatory measures the Cypriot authorities reiterated their view that the airline has in effect been restructuring its operations since 2004. In this respect at the end of 2004, the airline reduced its fleet by two aircraft and gave up a number of routes while at the same time reducing its frequency on other routes. In the context of a 12 aircraft airline in 2004 this reduction was, in their view, very significant and a further reduction in size at this stage would have a negative impact on the airline's long-term viability.

- (48) The Cypriot authorities also contend that the decision to sell HellasJet and the decision not to renew HellasJet's leases on three leased aircraft constitutes a significant Group capacity reduction which should be seen as a compensatory measure. Similarly the sale of Eurocyprria as the Group fleet will be reduced by 6 further aircraft, after the sale the two companies would be legally and financially independent.
- (49) In the view of the Cypriot authorities there is no further scope in this restructuring for further compensatory measure which would not risk imperilling the object of the restructuring. The Cypriot authorities stress that Cyprus Airways is a very small player in the Community aviation market and its actions are unlikely to influence the competitive situation in this matter.
- (50) The Cypriot market, which is mainly a destination market has been liberalised for some time and currently some 99 airlines operate scheduled and charter services in to and out of Cyprus. On closer examination 80 % of traffic is intra-Community/EEA and therefore not subject to restrictions of any kind. A further 8-9 % is made up of charter services from third countries which are fully liberalised. The remaining 10-11 % is made up of traffic from the Middle East and Gulf regions where the aero-political context is driven by bilateral arrangements between Cyprus and these countries. In this context the Cypriot authorities feel that there is very limited scope for further liberalisation of the Cypriot aviation market on the basis of actions taken at the national level.

#### *Own contribution*

- (51) In relation to the issue of own contribution the Cypriot authorities wished to clarify on a number of issues. In relation to the Cyprus Airways owned fleet, the company had not been able to place its aircraft as security against borrowing from commercial banks due to the relative age of the aircraft (the 7 A320 aircraft owned by Cyprus Airways were delivered to the company between 1989 and 1993). Efforts had been made in this regard and the replies received from a number of commercial banks had been negative. In similar vein the government explained that the sale of part of the fleet was not considered as a real alternative as this would render the company incapable of continued operations. The only real alternative therefore was the sale of Eurocyprria and they argue that the sale of this subsidiary should be regarded as an own contribution.
- (52) In relation to HellasJet this company ceased operations as a scheduled airline in May 2005 and transformed its business from a scheduled carrier to an aircraft broker and charter operator by entering into an agreement with a Greek company called Trans World Aviation. 51 % of the equity of the company had already been sold and the government were in negotiations to sell the rest of the company.
- (53) The Cyprus authorities also consider that the capital increase planned for mid-2007 constitutes an own contribution to the restructuring. In their opinion should

be added the sale of an aircraft in 2005 (CYP 5 million), the sale of a spare A320 aircraft engine (CYP 1,7 million) and the sale of spare parts (CYP 0,7 million), leading to a further contribution of CYP 7,4 million.

- (54) Finally, in relation to the level of own contribution to the restructuring the Cypriot authorities draw the attention of the Commission to point 56 of the R & R guidelines which provide

*'In assisted areas, however, and unless otherwise stipulated in rules on state aid in a particular sector, the conditions for authorising aid may be less stringent as regards the implementation of compensatory measures and the size of the beneficiary's contribution'*

- (55) They go on to point out that for the period 2000-2006 that the whole of Cyprus is considered as one region falling under Article 87(3)(a) of the EC Treaty, and that Cyprus Airways is particularly valuable to the tourism-based economy of Cyprus and further capacity reduction in the airline either through further compensatory measures or through an extremely high proportion of own contribution is bound to have far reaching repercussions on the tourism sector and on regional development generally.

#### Third party comments

- (56) Following the publication of the letter addressed to the Cypriot authorities in the Official Journal comments were received from one interested party within the time allowed.
- (57) The Commission notes that no competitor submitted comments within the context of the opening of procedure.

#### PASYPI

- (58) The Comment was received from the Pancyprian Airline Pilots Union (PASYPI), who wished to give their opinion on the restructuring plan for Cyprus Airways and on the proper and efficient management of the company. They expressed the opinion that if the current restructuring plan was to be approved under the 'prevailing management thinking' that this might be 'very disastrous' for the company.
- (59) In the opinion of PASYPI Cyprus Airways had not presented a proper and viable business plan to its employees since the Commission had authorised rescue aid for the company. No restructuring of either the management or the operations of the company had taken place and this was due to political interests and interference.
- (60) The union assert that the airline is overstaffed and that plans put in place by the company management had failed to reduce the number of staff to staffing levels consistent with international standards and benchmarking, political pressure and considerations were cited as reasons for this failure.

- (61) PASYPI point out that the private shareholders of the company do not contribute to its survival and that the only stakeholders who contribute to the reduction in costs are the employees.

- (62) The pilots' union also criticises the company management in relation to the treatment of two subsidiaries Eurocypria and HellasJet. In relation to Eurocypria they question whether the sale of this company will have adverse effects and limitations on the future of and expansion of Cyprus Airways. With respect to HellasJet the union takes issue with the fact that the management has never revealed to the staff the losses incurred by HellasJet and whether this company is still operating.

- (63) In conclusion the pilots' union states that there is a need for a new business plan for the airline and that the airline needs to be privatised.

#### Reply of the Cypriot authorities to the Third Party Comment

- (64) The Cypriot authorities reply to the comments received from the pilots' union was firstly to assert that the statements made were neither substantiated nor based on any solid business rationale or background.
- (65) The government firmly refutes the allegation of political interference in the company and stated that while the majority of the Board are appointed by the government that these members have the same responsibilities as those of the Board members of any publicly listed company. The decisions taken by the Board are motivated only by the company's best interests.

- (66) In relation to the restructuring plan the government states that this was being implemented and that change within the company was already visible. Savings on an annual basis were in line with those foreseen by the plan at CYP 19,5 million. The core of the plan is to reduce costs so as to give the airline the ability to restructure its operations more competitively. As labour costs were a significant factor this has meant that the staff had been unavoidably affected either through redundancy or through reduced earnings.

- (67) With regard to the issue of overstaffing the government rejects the allegations made by PASYPI and states that the number of staff to be made redundant due to leave the company by the end of 2006 is approximately 414 rather than the 385 persons envisaged in the restructuring plan.

- (68) Concerning the increase in capital, the government explain that this will take place in mid-2007 when tangible results from the implementation of the restructuring plan are evident. It is intended that the ratio of private/public shareholding in the company will be maintained.

- (69) The government explained that the sale of Eurocypria was taken to enable Cyprus Airways to meet the own contribution requirements of the Community R & R guidelines. They stated that the sale of Eurocypria at an independently evaluated price of CYP 13,425 million was to take place in early August 2006.
- (70) In relation to HellasJet the government explained that following a tripartite agreement between Cyprus Airways, HellasJet and Trans World Aviation SA (trading in Greece as Air Miles) Cyprus Airways had arranged for the sale of HellasJet to Trans World for EUR 2 million (CYP 1,16 million). They stated that Cyprus Airways's intention had been to mitigate as far as possible the operating losses of HellasJet and to extract itself from this venture once the corporate guarantees previously provided by Cyprus Airways in connection with HellasJet's fleet had expired and argued that this sum should be considered as an own contribution.
- (71) The government rejected the pilots' union call for a new restructuring plan and affirm that the current business plan does not require any revision. The government do not exclude the possibility of privatising the company should an attractive offer be made.
- (72) In relation to the capital increased planned for mid-2007 and at the request of the Commission, the Cypriot authorities provided further information by letter dated 19 December 2006. They explained that according to the provisions of Cypriot company law a public company may not issue shares below nominal value. As Cyprus Airways shares were at that time being traded on the Cyprus Stock Exchange at a value in the range of CYP 0,15-0,16 while they had a nominal value of CYP 0,50 per share. As it was felt that any issue at or above par value would be successful it would be necessary to reduce the nominal value of the share capital.
- (73) The procedure for the reduction of nominal share capital has already been undertaken and the company will reduce this value by writing off accumulated losses (as permitted by the Company's articles of association). The Board of Directors of Cyprus Airways in its meeting of 12 December 2006 began the procedure for the capital increase by organising the underwriting of the issue. To guarantee its success a commercial investment bank Cisco (a subsidiary of the privately-owned Bank of Cyprus) has indicated its willingness to underwrite the proposed issue. Cisco will be paid a fee for underwriting the Cyprus Airways' capital increase and this fee will be at market price for such transactions. A copy of the letter of intent of the investment bank has been furnished to the Commission services.
- (74) The next steps were that in mid-January 2007 a Special Resolution for the Reduction of the share capital was approved by a 75 % majority of the shareholders present at an extraordinary general meeting. Such a resolution would

then have to be ratified by the District Court in Cyprus and registered with the Registrar of Companies. The whole of this procedure is expected to take 6-7 months (allowing a three month period for the Court).

#### V. APPRAISAL OF AID

##### **Existence of aid within the meaning of Article 87(1) of the EC Treaty**

- (75) By virtue of Article 87(1) of the EC Treaty, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threaten to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between the Member States, be incompatible with the common market.
- (76) The concept of State aid applies to any advantage granted directly or indirectly, financed out of State resources, granted by the State itself or by any intermediary body acting by virtue of powers conferred on it.
- (77) In the context of the opening of procedure the Commission identified three elements of the restructuring plan which could potentially amount to state aid, the Commission must therefore examine these elements to determine if these constitute State aid.

##### *Loan Guarantee*

- (78) The restructuring costs of Cyprus Airways will be partially and temporarily covered by a CYP 55 million (EUR 96 million) loan granted by a commercial bank at market conditions. As explained in the decision to open the investigative procedure, the Cypriot authorities intend to grant to Cyprus Airways a State guarantee covering this loan.
- (79) The *Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees* <sup>(4)</sup> sets out criteria which ensure that a guarantee does not constitute State aid (see paragraph 4.2). Two essential cumulative conditions are:
- The guarantee could in principle be obtained at market conditions from the financial markets.
  - The market premium for the guarantee is paid.
- (80) In the present case neither of these criteria is fulfilled, Cyprus Airways does not pay the state any premium for the guarantee it benefits from and, given its parlous economic situation and the fact that it had already received rescue aid, it is very unlikely that the company would have received such a guarantee on its own.
- (81) Furthermore, the guarantee is one of State resources as it is granted directly by the State. It is directed at one company (Cyprus Airways) which is in competition with other Community airlines in particular since the entry into force

<sup>(4)</sup> OJ C 71, 11.3.2003, p 14.



of the third stage of liberalisation of air transport ('third package') on 1 January 1993. It will affect inter-state trade since it concerns a company involved in the activity of transport between Member States and covers the Common Market and as it may distort or threaten to distort competition inside this market.

- (82) The State guarantee therefore falls to be considered a State aid within the meaning of Article 87(1) of the EC Treaty. Moreover, this conclusion is accepted by the Cypriot authorities as in relation to the guarantee they have sought to fulfil the conditions established in the R & R guidelines.
- (83) While the initial plan provided that the Cypriot authorities would guarantee the CYP 55 million loan in full, in the course of the procedure, in order to limit aid to the minimum and to ensure a sufficient contribution of the company to cover its own restructuring costs, the authorities decided to reduce the part of the restructuring loan covered by the guarantee to a maximum of CYP 45 million. In addition, the Cypriot authorities specified that the guaranteed and the non guaranteed part of the loan will be independent and in particular that there will be no subordination of the latter to the former. This means that at least CYP 10 million of the CYP 55 million commercial loan will be obtained by the airline without any guarantee or other State intervention.

#### *Sale of Eurocypria*

- (84) The Cypriot authorities have indicated that the sale of Eurocypria has been completed in August 2006 and that the company has been sold to the State for CYP 13,425 million. The Commission must therefore examine how this price has been arrived at to verify its validity and to determine if there was any State aid involved in the transaction. Paragraph 59 and following of the decision to open the investigative procedure recalls that this might be the case, in particular, if the price paid is too high in comparison to the market price of the company.
- (85) In this regard, the Commission notes that this figure has been arrived at following two expert assessments carried out on behalf of both vendor and purchaser. Having carried out a detailed analysis of the expert valuations the Commission can conclude this price corresponds to fair market price; it also notes that the final sales price is, in any event, lower than the CYP 15 million foreseen in the restructuring plan and in the opening of the investigative procedure. The Commission therefore concludes that Eurocypria's sale does not amount to State aid to Cyprus Airways because the company has not been sold at more than its true value.

- (86) The Commission also notes the Cypriot authorities' stated intention that that Eurocypria will be operated as a completely independent company outside of the Cyprus Airways group; the Commission considers that as Eurocypria remains government owned the risk arises that it may not be operated truly independently of its former mother company. Accordingly and to address these concerns the Commission intends to impose conditions on Cyprus to ensure that the two companies are and remain separate for a sufficient period of time and that they conduct any business between them at arm's length.

#### *Capital Increase*

- (87) A further aspect of the restructuring plan is that in mid 2007 some 18 months after the start of restructuring the capital of Cyprus Airways will be increased by some CYP 14 million. It is the intention of the Cypriot authorities that this capital increase will take place in proportion to the current shareholding and that the public/private ownership ratio will be maintained. This will mean that the State will contribute CYP 9,8 million (EUR 17 million or 70 %) while the other shareholders' will add CYP 4,2 million (EUR 7,3 million or 30 %).
- (88) The Commission has therefore to determine if in this situation the public part of this proposed capital increase constitutes State aid. In doing so it bases its judgement on the 'market economy investor principle' an approach which has been confirmed by the jurisprudence of the Court <sup>(5)</sup>. According to the case law of the Court, to examine whether a public capital injection constitutes State aid, it is appropriate to take account of the real possibilities that the beneficiary company has to obtain equivalent financial resources in resorting to the normal capital markets. There is no State aid when new public capital is contributed under conditions which would be acceptable for a private investor operating under normal conditions of the market economy.
- (89) The behaviour of the public investor has therefore to be compared with the supposed behaviour of a private investor, such as a private holding or of a private group of companies pursuing a structural, overall or sectoral policy, and guided by prospects of long-term profitability <sup>(6)</sup>. Accordingly, the Commission considers that capital contributions from public funds are not State aid when private shareholders take part in the operation firstly at least proportionally to the number of their actions, secondly under conditions identical to those of the public investor and finally if the proportion of shares subscribed to by the private investors has a real economic significance; the Commission considers that parity for the participation of public and private investors is guaranteed when a

<sup>(5)</sup> See the judgement of the Court of 16 May 2002 in Case C482/99 2002 ECR I-4397 as well as the conclusions of Advocate general Geelhoed of 27 September 2001, in Joint cases C-328/99 & C-399/00, *Italy v Commission & SIM 2 Multimedia SpA v Commission*.

<sup>(6)</sup> Judgement of 21 March 1991, *Italy v Commission 'Alfa Romeo'* (C-305/89) 1991 ECR I-1603 point 20.

commercial bank or investor has agreed to guarantee in advance and at market conditions the participation of the private investors in the capital increase, at the same conditions as those offered to the public investor. This approach, based on the concomitance of contributions, has been regularly upheld by the Court of First instance and the ECJ (7).

- (90) In the present case, a commercial investment bank, Cisco has agreed at market conditions to underwrite the private investors to the extent of 30 % of the proposed recapitalisation. It is also specified by the Cypriot authorities that all shareholders will purchase the shares at the same value, to be determined jointly by Cyprus Airways and Cisco, and under the same market conditions as the private investors.
- (91) In this connection, the Commission has received a copy of the letter of intent dated 14 December 2006 sent to Cyprus Airways by Cisco where the bank accepts to conclude a contract to underwrite or have underwritten the success of the recapitalisation operation. In addition, before committing itself in respect of the investment vis-à-vis private investors, Cisco has carried out a detailed study of the restructuring plan and of the operation. Furthermore, before concluding the final contract, as is usual market practice, it will carry out (or have carried out on its behalf) a due diligence operation which any investor should carry out before initiating the operation. In this way the bank surrounds itself with all the guarantees and securities enabling it to adjust its offer to the risks taken. It should be noted that this bank is not controlled, directly or indirectly, by the Member State concerned. The final guarantee contract with Cisco will be concluded close to the beginning of the offer period and will contain the standard provisions and undertakings in force in this type of contract and in accordance with best national and international practices.
- (92) The conditions to which the conclusion of the final guarantee contract are subject may be grouped together in two blocks; the first concerns relatively standard elements with no direct influence on the Commission's assessment but only on its actual implementation. They include:
- a) the absence of extraordinary events which could be detrimental to the successful completion of the operation,
  - b) the transmission to the bank of complete information on the economic and financial situation and on the management of Cyprus Airways,
  - c) the involvement of the bank in determining the procedures for the operation,
- (93) On the other hand, the second block of conditions set out in the bank's letter of intent are liable to affect the assessment of the operation by the Commission; they should be analysed in detail, these mainly concern:

- a) the difference in the share issue price relative to the stock market quotation,
  - b) the fees/commissions to be charged by the bank for the operation,
  - c) the agreement by both the bank and the State (Cyprus Airways 's principal shareholder) that they will both participate in the capital increase.
- (94) So far as concerns the *subscription price for the new shares*, Cisco and Cyprus Airways have agreed that the price or price range for the issue of the new shares will be defined jointly in accordance with market practices in the light of the stock market conditions prevailing at the time of the launch of the operation. Cyprus has confirmed to the Commission that a single price will be charged for all the subscribers involved and that no specific discount will be granted to the guarantor.
- (95) So far as concerns, secondly, the *remuneration of the banks through commissions*, the latter are based on the value of the proportion of the operation (30 %) to be subscribed by the market. The Cypriot authorities have indicated that the fee to be paid to Cisco is in accordance with market principles on the main European stock markets so as to guarantee the successful completion of a comparable share placement operation. The Commission can conclude therefore that the transaction between Cyprus Airways and Cisco is in accordance with market conditions for this type of operation and that it does not amount to a discount on the price paid by the bank for the shares that it may be called upon to subscribe. Consequently, the fee paid to the bank does not have the effect of enabling it to participate in the operation on more favourable conditions than the State or the other shareholders.
- (96) So far as concerns, thirdly, *the requirement by both State and bank that the other participate in the capital increase*, the Commission would point out that the requirement of both parties that the other participate in the exercise is an essential decisive element to guaranteeing the success of the capital increase.
- (97) The Commission notes the undertaking given by the Cypriot authorities to transmit the final contracts with the bank containing these formal and unconditional subscription obligations to the Commission immediately after conclusion and before subscription of the new capital increase by the public authorities. A second undertaking given by the Cypriot authorities is to submit a report containing the actual subscription levels for this capital increase once the operation has been carried out. In this connection, the Commission considers that it goes without saying that there cannot be collateral or implicit agreement whereby the State would exonerate the bank from their obligation if the recapitalisation offer was insufficiently subscribed. The Commission will pay the utmost attention

(7) Judgement of the CFI of 12 December 2000 in Case T-296/97, *Alitalia v Commission*, 2000, ECR II-3871, point 81.

to strict compliance with these undertakings so as to ascertain that the terms of the present decision will be properly adhered to.

- (98) This operation enables the private market to subscribe to a significant extent (30 %) in respect of the shares newly issued under the same conditions as the public shareholders given that the share prices will be identical and the rights attaching to each share will be the same for all shareholders.
- (99) In summation, in view of this analysis and of the constant practice of the Commission and the case law of the Court as regards the qualification of State participation in capital increases together with private investors, looked at on its own merits and independent of the other restructuring measures, the capital increase planned for mid-2007 amounts to a concomitant participation of public and private shareholders and therefore the participation of the State would not amount to State aid if the conditions set out above, relating to the fact that the capital increase will be underwritten by a commercial investment bank in a way ensuring effective concomitance of public and private subscription and to the ratio of public to private ownership, are complied with.
- (100) Nevertheless, the Commission notes that the jurisprudence of the European Courts indicates that *'the mere fact that a public undertaking has already made capital injections into a subsidiary which are classed as aid does not automatically mean that a further capital injection cannot be classed as an investment which satisfies the private market economy investor test... Nevertheless, it is the Court's view that in a case such as this, which concerns three capital injections made by the same investor over a period of two years the first two of which brought no return, the Commission must determine whether the third injection could reasonably be severed from the first two and classed, for the purposes of the private investor test, as an independent investment.*

*The Court considers the following considerations to be relevant in making such a determination: the chronology of the capital injections in question, their purpose, and the subsidiary's situation at the time when each decision to make an injection was made' (8).*

- (101) In the present case, the Commission notes that while the State and the private shareholders will subscribe to the capital increase at the same price and all the new shares will have the same rights, the fact is that the State acts, at the same time, as the guarantor of a significant loan to the beneficiary and that this will extend far beyond the moment of the capital increase, and purchases a subsidiary of the company being restructured. However, it is not necessary to assess with precision whether, given the cumulation of the capital increase with these two measures, the State participation and the private shareholders'

participation in the capital increase actually happen on similar terms since at any rate, the Commission considers that, as is clear from the following analysis, even if the State participation in the capital increase were to be considered as State aid that this aid would be considered as compatible with the common market.

### Legal basis for appraisal

- (102) Having concluded that the long term loan of CYP 55 million guaranteed by the state to finance part of the restructuring of Cyprus Airways constitutes State aid and that the State participation in the capital increase could contain elements of State aid, the Commission must examine its compatibility with the common market.
- (103) It is therefore necessary to examine the compatibility of the aid in the light of Articles 87 (2) and (3) of the EC Treaty which provided for exemptions to the general rule of incompatibility set out in Article 87(1).
- (104) The exemptions in Article 87(2) of the EC Treaty do not apply in the present case because the aid measure does not have a social character in that it is not granted to individual consumers, nor do they make good the damage caused by natural disasters or exceptional occurrences nor are they granted to the economy of certain areas of the Federal Republic of Germany affected by its division.
- (105) The exemptions in Articles 87(3)(a), 87(3)(b) and 87(3)(d) do not apply in this case because the aid does not promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment, it does not promote the execution of an important project of common European interest or remedy a serious disturbance in the economy of a Member State nor does not promote culture and heritage conservation.
- (106) Therefore only the exemption provided for in Article 87(3)(c) may apply. Article 87(3)(c) provides that state aid can be authorised where it is granted to promote the development of certain economic sectors and where this aid does not adversely affect trading conditions to an extent not contrary to the common interest.

- (107) In this respect, the applicable community framework for deciding on compatibility are the R & R guidelines of 2004 as well as the previously mentioned 1994 guidelines.

### Compatibility of the intended measures with the common market

- (108) The Commission has therefore to assess whether the restructuring plan complies with the provisions of the applicable guidelines. The basic principle (point 31 of the R & R guidelines) of which is to *'allow the grant of restructuring*

(8) Case T11/95 *BP Chemicals Ltd v. Commission* [1998] ECR II-3235 paragraphs 170 & 171.

*aid only in circumstances in which it can be demonstrated that it does not run counter to the Community interest. This will only be possible if strict criteria are met, and if it is certain that any distortions of competition will be offset by the benefits flowing from the firm's survival...and that, in principle, there are adequate compensatory measures in favour of competitors.'*

- (109) The guidelines then set out a number of conditions under which restructuring aid can be granted.

#### *Eligibility of the firm*

- (110) First, the Commission must determine if Cyprus Airways is eligible for restructuring under the terms of the R & R guidelines. Point 9 of the guidelines states that there is not a Community definition of a company in difficulty, and add that *'the Commission regards a firm as being in difficulty when it is unable, whether through its own resources or with the funds it is able to obtain from its owners/shareholders or creditors, to stem losses which without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term'*.
- (111) Subsequently the guidelines (point 10) clarify that *'a firm is, in principle and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines in the following circumstances (a) in the case of a limited liability company where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months'*.
- (112) In point 11 it is also stated that *'Even when none of the circumstances set out in Point 10 are present a firm may still be considered to be in difficulty in particular where the usual signs of a firm in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value'*.
- (113) The Commission has noted in the opening of procedure that Cyprus Airways is a company with limited liability which has already lost a significant part of its authorised capital. At 31 December 2003, Cyprus Airways had an authorised capital of CYP 55,5 million (EUR 95 million) but by 31 December 2004 it had lost CYP 26,2 (EUR 44,8 million), close to 50 % of its share capital, in the previous 12 months.
- (114) The Commission noted that losses of the Group (mainly caused by Cyprus Airways) went from CYP 20,9 million in 2003 to CYP 39,4 million by the end of 2004. The shareholder equity of Cyprus Airways had therefore declined from CYP 55,6 million (EUR 95 million) in 2003 to CYP 14,4 million (EUR 25 million) in 2004. It is therefore highly unlikely given its parlous financial state

that the company would be able to secure any source of commercial finance.

- (115) In its decision of 3 May 2005 on 'Cyprus Airways (Rescue aid)' the Commission concluded therefore that Cyprus Airways is well and truly a company in difficulty within the meaning of the R & R guidelines. This was also the conclusion reached by the Commission in opening the procedure. Cyprus Airways is therefore eligible for restructuring under the terms of the R & R guidelines.

#### *Restoration of long-term viability*

- (116) The second condition (as set out in point 35 of the R & R guidelines) to be complied with is that the *"restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions"*.
- (117) The same guidelines (point 37) go on to provide that *'The plan must provide for a turnaround that will enable the company, after completing its restructuring, to cover all its costs including depreciation and financial charges. The expected return on capital must be enough to enable the restructured firm to compete in the marketplace on its own merits.'*
- (118) Thus far in the restructuring the company has reduced its costs by CYP 19,5 million and has shed more staff than were foreseen by the restructuring plan. The plan foresaw a reduction of 385 staff (out of 1800) and eventually 414 persons availed of the possibility to leave the company. This significant downsizing in the cost base together with the negotiated decreases in salary for remaining staff as well as increases in productivity and work practices will provide major savings and should give the company the necessary flexibility and the adaptability going forward to achieve its objectives.
- (119) The Commission considers that Cyprus Airways should be capable of making a success of its restructuring within the prescribed time limit. Indeed, although only 18 months has elapsed since the grant of rescue aid (May 2005) the results for the company are already slightly better than anticipated. For further improvement attention should be paid to employees' opinions on how to manage the necessary restructuring. In cases of this type the management of the restructuring is very important and the third party comment received shows that this may be especially so in this case.
- (120) In relation to the long-term loan of CYP 55 million (EUR 96 million) partially guaranteed by the State, the Cypriot authorities have demonstrated that this sum will be used (along with the sales proceeds for the sale of Eurocypria) to repay the rescue aid to restructure the

airline over the coming years. The capital increase of CYP 14 million planned for mid-2007 will be used to reduce the outstanding amount of the loan. The restructuring plan is closely linked with a cost cutting plan so as to maximise revenue. Over time it is intended to grow the revenue of the company and to thereby repay the remaining amount of the loan to the bank from revenue.

(121) The Commission must also evaluate if the assumptions on which the restructuring has been based are reasonable in the circumstances and if the predictions and forecasts correspond with what is required in the guidelines. The R & R guidelines provide (point 35) that *'The plan must be submitted in all relevant detail to the Commission and include, in particular, a market survey. The improvement in viability must derive mainly from internal measures contained in the restructuring plan; it may be based on external factors such as variations in prices and demand over which the company has no great influence, but only if the market assumptions made are generally acknowledged.'*

(122) In this respect it can be verified that this part of the restructuring plan has developed as predicted. In the present case, with regard to the traffic flows and development of the market the Commission refers to the two independent studies carried out in relation the valuation of Eurocypria in as much as these relate the development of the Cypriot aviation market.

(123) According to the restructuring plan Cyprus air traffic is assumed to increase by 3,5 % on average per annum over the years 2005-2010, while Cyprus Airways traffic projections will grow at a rate of 2,4 % on average per annum over the years 2005-2010. In the report prepared by PwC the overall growth for Cyprus air traffic is forecast by IATA (the International Air Transport Association) at 4,3 % over the 2006- 2008 period, this suggests that the assumptions taken into consideration in the plan were reasonable. Therefore, the forecasts of the restructuring plan in terms of Cyprus Airways' results appear plausible, having regard to the other rationalisations carried out by the company.

(124) In the light of the above-mentioned factors, the Commission considers that Cyprus Airways will be able to find its financial viability within a reasonable time, as foreseen by the business plan.

#### Compensatory measures

#### Cyprus Airways

(125) The R & R guidelines also provide (point 38 thereof) that *'In order to ensure that the adverse effects on trading conditions are minimized as much as possible, so that the positive effects pursued outweigh the adverse ones, compensatory measures must be taken. Otherwise, the aid will be regarded as contrary to the common interest' and therefore incompatible with the common market.'*

(126) It is further specified (point 39) that *'These measures may comprise divestment of assets, reductions in capacity or market presence and reduction of entry barriers on the markets concerned. When assessing whether the compensatory measures are appropriate the Commission will take account of the market structure and the conditions of competition to ensure that any such measure does not lead to a deterioration in the structure of the market'...*

(127) The Commission must therefore examine the restructuring and determine if sufficient measures have been taken in relation to Cyprus Airways and the Cyprus Airways group so as to minimise the distortive effect of the aid.

(128) At the end of 2004 the company initiated what was called an 'action plan' and began by reducing its fleet by two aircraft one of which was subsequently wet-leased to Eurocypria and gave up a number of routes previously served by it being Warsaw, Budapest and Colombo.

(129) In this framework, the fleet of the airline was reduced by one aircraft at the end of 2004; at the time of the implementation of the restructuring plan Cyprus Airways operated 10 aircraft (2 A319, 6 A320-200 and 2 A330-200) and wet-leased out a further A320-200 to Eurocypria, this wet lease arrangement was brought to an end at the end of the 2006 summer season. In addition, the Commission notes that air traffic growth prospects range from 3,5 to 4,3 % per annum on average over the years 2005-2010, while Cyprus Airways projections foresee a growth of 2,4 % per annum, which will lead to a market share decrease from 26,6 % to at most 23,2 % over the period. The Commission can accept that any further reduction in the size of the fleet or market share would risk jeopardising the possibilities of the airline to recover without providing any meaningful market opportunities for competitors.

(130) In the opening of procedure the Commission specifically invited observations of interested third parties in this regard; no comments on this issue were received.

(131) In addition, the Commission underlines that the R & R Guidelines (point 55) provide that as 'Economic and social cohesion (are) a priority objective of the Community...the Commission must take the needs of regional development into account when assessing restructuring aid in assisted areas'. It is further provided (point 56) that in 'assisted areas ... the conditions for authorising aid may be less stringent as regards the implementation of compensatory measures and the size of the beneficiary's contribution'.

(132) In this context it should be recalled that for the period between 1 May 2004 and 31 December 2006 <sup>(9)</sup> the whole of Cyprus was eligible under the derogation of Article 87(3)(c) of the EC Treaty. For the period 2007-2013

<sup>(9)</sup> State aid CY 14/2003 — Cyprus — Regional aid map 2004-2006 (C(2004) 1757/1 of 28.4.2004).

two regions covering together 50 % of the Cypriot population should be eligible to receive regional investment aid under the derogation of Article 87(3)(c) of the EC Treaty at an aid intensity of 15 %. Furthermore, Cyprus exhibits a number of territorial, and, therefore permanent, characteristics which impact on its socio-economic development. Cyprus's southern peripherality results in direct problems with respect to accessibility to the rest of the European Union and as a result the country is extensively dependent on air and sea transport, but particularly on air transport. This is important as in the case of Cyprus, air travel is the only viable means of business passenger transport. Eurostat statistics for 2003 which calculate the so called 'air dependency' of an economy demonstrate that Cyprus is the most highly dependent Member State on air travel<sup>(10)</sup>.

### Conclusion

- (133) In this regard and having regard to the particularities of the air transport market in Cyprus and on the basis that Cyprus Airways has already reduced its fleet and that the former subsidiary Eurocypria will now operate as a legally and financially independent business outside of the ownership and control of Cyprus Airways the Commission can conclude that sufficient compensatory measures have been proposed by the Cypriot authorities to address the market distortions that will be occasioned by the restructuring.

### *Aid must be reduced to the minimum*

- (134) The R & R guidelines (Point 43) of the guidelines provide that the *'amount and intensity of the aid must be limited to the strict minimum of the restructuring costs necessary to enable restructuring to be undertaken in the light of the existing financial resources of the company, its shareholders or the business group to which it belongs. Such assessment will take account of any rescue aid granted beforehand'*. The Commission considers that this condition is fulfilled.
- (135) Indeed, on the one hand, as recalled above, the restructuring costs amount to CYP 71,1 million. On the other hand, the revenues used to finance this restructuring include the CYP 55 million loan (partially guaranteed by the State), CYP 13,425 million of sales proceed of Eurocypria, plus around CYP 8,5 million of other resources, coming in particular from the divestment of various assets. The proceeds of the planned capital increase should not be added to these measures, as it will be used in full to reimburse part of the CYP 55 million loan, and will therefore not increase the total amount of the resources utilised for the restructuring, but only substitute for an equivalent part thereof. The resources therefore amount in total to around CYP 76,9 million. The Commission finds this amount acceptable, and concludes that there is no excess of permanent resources in comparison to the corresponding costs, since the major part of the

restructuring resources is made up of a loan which will have to be reimbursed by the company out of its own results and therefore does not constitute permanent funding whereas the company has to face definitive restructuring costs.

- (136) Additionally, the Commission notes that the commitment of the Cypriot authorities to reduce the part of the CYP 55 million loan that will be covered by the government guarantee amounts to a further limitation to the State aid element in comparison to what was initially foreseen.

### *Level of own contribution*

- (137) In relation to the level of own contribution the guidelines (point. 43) provide that *'Aid beneficiaries will be expected to make a significant contribution to the restructuring plan from their own resources, including the sale of assets that are not essential to the firm's survival, or from external financing at market conditions. Such contribution is a sign that the markets believe in the feasibility of the return to viability. Such contribution must be real, i.e., actual, excluding all future expected profits such as cash flow, and must be as high as possible.'* The guidelines then indicate what level of own contribution would normally be considered as appropriate; for a company the size of Cyprus Airways this rate would be 50 %.
- (138) The Commission has established that the restructuring costs will be approximately CYP 71,1 million.
- (139) The amounts which should be considered as own contribution will consist of: at least CYP 4,2 million corresponding to the part of the CYP 14 million capital increase that will be underwritten by the private investors; at least CYP 10 million of the CYP 55 million commercial loan that will be borrowed by the airline on the markets without guarantee or other State intervention; as well as the CYP 8,5 million (as set out in paragraph 53 above) of sales proceeds of various assets.
- (140) The Cyprus authorities also argue that the sale proceeds from the sale of Eurocypria should also be considered as own contribution. The practice of the Commission in this regard<sup>(11)</sup> is that if such a sale takes place at the real value of the assets (independently of the nature of the buyer) it does not constitute State aid to the enterprise selling the assets. The sales proceeds of these assets may then be used to finance the restructuring and should be regarded as making up an own contribution. This means that the sales proceeds from the sale of Eurocypria of CYP 13,425 million must also be considered as own contribution. This conclusion is further reinforced in the present case by the commitment from the Cypriot authorities and the condition imposed by the Commission that Eurocypria will be effectively run as a separate entity from and a real competing airline with Cyprus Airways.

<sup>(10)</sup> Cyprus has an air passenger per head of population ratio of 8,50, by way of comparison the EU 25 ratio is 1,30.

<sup>(11)</sup> Commission Decision 2005/406/EC of 15 October 2003 concerning RTP — (OJ L 142 of 6.6.2005, p. 1 and Commission decision 2005/418/EC of 7 July 2004 concerning Alstom OJ L 150 of 10.6.2005, p. 24) (in particular points 125 and 215).

(141) This results in a total own contribution of at least CYP 36,2 million. This amounts to 51 % of the restructuring costs. The Commission can therefore conclude that the requirement to contribute a sufficient amount to the restructuring costs has been met in the present case.

(142) The Commission further stresses that the restructuring costs are in majority covered by a loan of CYP 55 million, which, even if its has been partly guaranteed by the State, will have to be reimbursed by the company out of its own results, and not by a CYP 55 million State grant <sup>(12)</sup>. The effort that the company will have to produce in order to cover, over time, the costs of its own restructuring has the same effect as own financing of its restructuring, the only difference being that this effort can be spread over several years thanks to the commercial loan guaranteed by the State

In the light of the foregoing considerations, the Commission,

HAS ADOPTED THIS DECISION:

#### Article 1

The restructuring aid granted by Cyprus to Cyprus Airways Public Ltd is deemed to be compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty provided that the conditions laid down in articles 2 to 5 are complied with.

#### Article 2

Cyprus shall, by 31 December 2007, submit a report to the Commission on the progress of and the management of the restructuring plan.

#### Article 3

1. Cyprus shall ensure that Cyprus Airways Public Ltd and Eurocypria are and continue to be operated as fully competing companies. Cyprus Airways Public Ltd and Eurocypria shall be run as separate legal entities. Neither Cyprus Airways Public Ltd nor Eurocypria shall be allowed to acquire any shareholding in the other and no equivalent capital operation, such as a merger, shall be carried out between both companies. All transactions between Cyprus Airways Public Ltd and Eurocypria shall be conducted at arm's length.

2. Paragraph 1 shall apply until either:

- a) the loan guarantee granted by Cyprus to Cyprus Airways Public Ltd is brought to an end; or

- b) Cyprus no longer has direct or indirect majority participation and/or control in the capital of both companies.

#### Article 4

Cyprus shall ensure that the capital increase to the extent of CYP 14 million (EUR 24,3 million) in Cyprus Airways Public Ltd foreseen for mid-2007 respects the following conditions:

- a) the capital increase will not take place until a formal unconditional commitment to underwrite the successful outcome of the operation has been signed by the appointed underwriting commercial bank with the exception of the usual conditions concerning cases of force majeure, acts of war, terrorism and other similar cases;
- b) the State can only subscribe in the capital increase up to a maximum of 70 % thereof,
- c) the State subscribes the new shares issued on the basis of the same rights and under the same conditions, at the same price as the private investors, without prejudice to the proposed timetable for the underwriting by the bank of the successful completion;
- d) the operation must not be accompanied by any collateral agreement or implicit agreement whereby the State would exonerate the bank from its obligation if the recapitalisation offer was insufficiently subscribed or grant the bank any special discount on the issue price.

#### Article 5

Cyprus shall provide the Commission with any reports and documents concerning both the participation of the State and of the bank and the private shareholders of Cyprus Airways Public Ltd and particularly the final contracts with the bank and the reports justifying the fees and eventual share price in the context of the capital increase.

#### Article 6

This Decision is addressed to Cyprus.

Done at Brussels, 7 March 2007.

For the Commission

Jacques BARROT

Vice-President of the Commission

<sup>(12)</sup> In this regard see Commission decision (2005/346/EC) of 14 July 2004 concerning MobilCom (O) L 116 of 4.5.2005 (in particular point 173).