

**Study of Application Process for and Operation of
'Start-up Aid for Airlines Departing Regional Airports'**

Western Development Commission

19th January 2011



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1 Executive Summary

1.1 Introduction and Context

The Western Development Commission (“WDC”) is a statutory body promoting economic and social development in the Western Region (counties Donegal, Sligo, Leitrim, Roscommon, Mayo, Galway and Clare) (www.wdc.ie).

One of the WDC’s main work areas involves the analysis of key policy issues affecting the development of the Western Region. The WDC is reviewing air access into the Western Region and wishes to gain a greater understanding of European Union (“EU”) regulations on State aid, in particular, the EU Community guidelines on start-up aid for airlines departing regional airports (the “Guidelines”) and the application and experience of these rules and any alternative options.

The objectives of the report (the “Report”) are to:

- Outline the various steps required in submitting an application to gain EU approval for aid for route development from ‘regional’ airports, with particular reference to the EC Guidelines.
- Describe how the Guidelines operate in practice and examples of ‘best practice’ in devising a scheme for EU approval.
- Outline the likely process, within an Irish context, for application and administration of a compliant scheme, and sets out the roles of all relevant stakeholders.
- Identify case studies of a similar scheme in operation and an alternative option for supporting route development as well as examining the ‘post aid’ performance of these schemes.

1.2 State Aid Overview

State aid rules are in place to prevent the use of public sector funding to distort or threaten to distort competition, or affect trade between Member States by favouring certain parties.

State aid rules apply only to measures that satisfy all of the criteria listed in Article 87(1) of the Treaty, in particular:

- **Transfer of State resources**
State aid rules cover only measures involving a transfer of state resources (including national, regional or local authorities, public banks and foundations, etc.). The aid does not need to be granted by the State itself, it may also be granted by a private or public body appointed by the State.
- **Economic advantage**
The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business.
- **Selectivity**
State aid must be selective and affect the balance between certain firms and their competitors. This “selectivity” is what differentiates State aid from “general measures” i.e. measures which apply without distinction to all firms in all economic sectors in a Member State. A scheme is considered “selective”, if the authorities administering the scheme have a degree of discretionary power.
- **Effect on competition and trade (and de minimis aid)**
Aid must have a potential effect on competition and trade between Member States. It is sufficient if it can be shown that the beneficiary is involved in an economic activity and that it

operates in a market in which there is trade between Member States. The nature of the beneficiary is not relevant in this context (even a non-profit or State owned entity can engage in economic activities).

Small amounts of aid ("de minimis aid") up to €200,000 over a 3 year fiscal period do not need to be notified as they are viewed as having a negligible impact on trade and competition between Member States.

Notification and authorisation procedures

Member States are required to inform the European Commission ("EC") of any plan to grant or alter State aid and are not allowed to put such aid into effect before it has been notified and authorised by the EC. Any aid, which is granted in the absence of EC approval, is automatically classified as "unlawful aid".

The EC is obliged to order the recovery from the beneficiaries of any unlawful aid found to be incompatible with the common market.

A process of modernisation and simplification of State aid procedures led to a new General Block Exemption Regulation ("GBER") being adopted in 2008 which introduced further new types of measures which are exempted from the notification obligation. However, the GBER cannot be used for aid given to support air route development.

For aid requiring approval, the Member State must notify the planned aid measures, through their Permanent Representation in Brussels. To speed up the process, the EC provides standard notification forms for most types of aid. Dedicated software ("SANI") has been developed for Member States to facilitate and accelerate the notification process.

If the notification is incomplete, the EC will request further information with the Member State usually given 20 days to supply this information.

The EC has two months to examine the proposed aid. The two month period runs from the date the EC has received all of the information it needs to assess the case and the notification can be considered to be complete. This examination will normally be concluded either by a decision not to raise objections, or by a decision to initiate Article 88(2) proceedings.

If the EC decides not to raise any objection, the aid measure can be implemented.

However, if it has doubts about the compatibility of the notified aid measure with the common market, the EC initiates Article 88(2) proceedings and opens a "formal investigation" which has no time limits.

All decisions are subject to review by the European Court of Justice under Article 230 of the Treaty. National courts also play a role with respect to enforcement of EC recovery decisions.

Market Economy Investor Principle ("MEIP")

If the State is acting in a way that a private investor would in a market economy, for example in providing loans or capital on terms that would be acceptable to a private investor, it is not providing State aid within the meaning of Article 87(1).

The general rule is that the investment should be on equal terms with the private investor (50/50). The onus is on the Member State to be able to demonstrate, if challenged, that the funding is on genuinely commercial terms, and the public sector is accepting the same risks and returns as the private sector.

1.3 State Aid in the Aviation Sector

Directorate-General for Mobility and Transport is responsible for regulating the transport industry including the air transport sector. State aid related issues for the transport sector now reside in Directorate-General Competition ("DG COMP").

The EC has continuously developed its position on the existence of State aid to airports and start-up aid to airlines. Relevant developments include the 1998 decision relating to Manchester Airport, the 2004 decision on the advantages to Ryanair at Charleroi Airport and the resulting 2005 guidelines on financing of airports and start-up aid to airlines operating from regional airports (the "Guidelines").

A number of approvals have been granted to schemes developed around the Guidelines requirements. However, the EC received a set back in December 2008 when the Court of First Instance ("CFI") upheld Ryanair's appeal relating to the EC's 2004 Charleroi decision.

The EC has subsequently announced a review of the 2005 Guidelines, partly as a result of the CFI judgment and partly to fulfill its commitment within the Guidelines for a review. This is expected to take place during 2011.

1.3.1 Charleroi decision (2004)

The EC received a complaint in January 2002 that the Walloon Region and Charleroi Airport (owned by the Walloon Region) had granted Ryanair a number of advantages for the operation of air services:

- Preferential rate for landing charges at Charleroi of €1 per boarding passenger (circa 50% of the standard rate) - no other airline benefited from this rate.
- Contribution towards promotional activities of €4 per boarding passenger, over 15 years and for up to 26 flights daily - no other airline benefited from this.
- Initial incentives amounting to €160,000 per new route opened for 12 routes (€1,920,000 in total); €768,000 in reimbursements for pilot training; €250,000 for hotel accommodation costs - no other airline benefited from this.
- Preferential rate of €1 per passenger for ground handling services (rates normally charged to other airlines was €8-13) - no other airline benefited from this.

The EC had to determine whether the measures taken in favour of Ryanair by the Walloon Region and the airport were in keeping with the market economy investor principle i.e. that State aid was not present.

This would require the advantages to be granted on the basis that the public undertaking has the same objectives of long-term profitability as a comparable private firm.

The EC concluded that no private operator in the same circumstances as the Region and the airport would have granted the same advantages due to:

- The level of expected profits over a period of 10 to 15 years, having considered the revenue and cost assumptions in the business plan.
- The extent and nature of the associated risks.
- Lack of formal guarantees from the Walloon Region regarding the continuity of fire and maintenance compensation and capping of contribution to the Environment Fund.

Since the market economy investor principle was not adhered to in this case, the advantages granted to Ryanair alone and for a long period, without transparency, were deemed to constitute State aid which could distort competition in favour of Ryanair.

The EC positioned the decision as having major significance for the future of air transport by ensuring full and fair competition between carriers operating out of regional airports for the maximum benefit of consumers.

The Charleroi decision appeared to reinforce the earlier Manchester decision with a detailed articulation of the principles of how public sector investment can be used to develop new routes from airports:

- Marketing support for the establishment of a new route is allowed for a limited duration (up to 5 years), where support can be proven to have been directly spent on marketing that particular route, and where support is proportional to the objective being pursued.
- Discounted airport charges are allowed, again for a limited duration, but must be fully transparent and not structured to favour one carrier over another.
- Discounts on other aviation-related activity, including ground handling, must also be transparent and must relate to the cost of service provision. Cross-subsidy from commercial income-generating activities may also be taken into account under certain circumstances.

1.3.2 EC Guidelines on financing of airports and start-up aid to airlines operating from regional airports (2005)

Following the Charleroi decision, the EC published their Guidelines in December 2005 which are aimed at regulating abuse of competition rules relating to public sector aid to low cost carriers.

The EC introduced a simple airport passenger throughput criterion as the proxy for market competition and eligibility for the receipt of public aid:

- Category A: airports above 10 million passengers cannot receive any new route start-up aid.
- Category B: airports between 5 and 10 million passengers are ineligible for aid unless exceptional cases can be made.
- Category C: airports between 1 and 5 million passengers are eligible for aid (Shannon Airport).
- Category D: airports with less than 1 million passengers are eligible for aid (Knock, Galway, Sligo and Donegal Airports).

Underlying the concept of time limited start-up aid as opposed to ongoing operating subsidy, a new service must become financially self-sustaining within a reasonable period. To ensure transparency, all proposed aid must be notified in advance to the EC for approval.

The Guidelines claim to welcome start-up aid provided to airlines in the form of incentives to share the risk of starting new routes from regional airports (in reality, most of the financial risk sits with the carrier).

This is positioned as a mechanism to increase passenger volumes at regional airports and therefore their financial viability in the long run. There is also recognition by the EC that the larger carriers have concentrated their services at congested hub airports where investment in facilities has also been focussed over the years. This is one of the main reasons why the EC can approve public aid paid to airlines, under certain conditions, if it is time limited and contributes to the airport breaking even within a foreseeable period.

Increases in air services are also in line with wider Community aspirations for better economic and social integration, with developing regional airports contributing to various EU policies:

- Increased use of regional airports helps to reduce congestion at the major European hubs.
- More access points for intra-European flights increases mobility and integration of citizens.
- Developing regional airports helps develop competitiveness of the regional economies.

The EC recognises the principle of the private investor in a market economy and that public sector investment is often made with the same objectives of those of the private market investor. The EC also recognises that any profitable airport can apply incentive measures from its own resources. In

this way the EC argues that the Guidelines make no differentiation between public and private sector ownership of airports.

A public airport must be able to prove that it acts as a 'private market investor' with a business case showing the forecast profitability for the airport from investment in a new route. If the business case makes sense, State aid rules do not apply. However, the airport remains subject to all other general rules of the Treaty in relation to incentive measures including transparency, non discrimination and proportionality.

If the market economy investor principle cannot be demonstrated, there is an obligation to notify the EC of the use of public funds. The obligation to notify applies to all airports or public bodies planning to implement publicly funded incentive measures, irrespective of the size of the airport.

The 2005 Guidelines set out detailed conditions that must be satisfied for the aid to be approved.

General conditions

- Air carriers must hold a valid operating license issued by a Member State.
- The aid is related to development of routes between Community airports. This would imply that intercontinental routes (e.g. to the US) and routes outside of the EC are either not covered by the Guidelines or are excluded from receiving start-up aid.
- Aid can only be given to routes departing from Community airports in Category C (1-5 million passengers - Shannon) and D (<1 million passengers - Knock, Galway, Sligo and Donegal).
- Aid can only be given for new routes or increased frequency on existing routes that do not compete with existing services, and must increase the net volume of passengers to improve the overall financial viability of the regional airport.
- Aid cannot be granted when a route is already served by high-speed train services. This is not an issue for the Western Region which does not have such services.
- Aid can only be granted to develop a new route or increased frequency and cannot be used to replace an existing or similar route from the same or another airport serving the same city, conurbation or airport system (e.g. airports in the Paris or London systems).
- The aid must not encourage transfer of traffic from one carrier to another or from one airport to another.
- The long term financial viability of the route must be demonstrated.
- Aid should stop once the objectives in terms of passengers carried or route profitability break even have been achieved, even if either of these is achieved before the end of the aid period.
- The aid must be limited in duration with a maximum of three years. Aid can be granted for up to 5 years for outermost, sparsely populated or disadvantaged regions. Routes from the Western Region may qualify for aid of up to five years if the EC accepts that the region fulfils the criteria.
- The aid must be degressive i.e. reduce over time. Intensity of the aid cannot exceed 30% of the total allowable start-up costs for a maximum period of 3 years, and a maximum of 50% of the eligible costs over the first year.
- For the nine outermost EU regions, aid cannot exceed 40% of total allowable start-up costs for a maximum period of 5 years, and a maximum of 50% of eligible costs over the first three years.

- Aid per passenger must reduce as passenger numbers increase. In an example of degressive structuring to maximise front end aid, the Year 1 aid could be a maximum of 50% with the remaining 40% (i.e. 3 x 30% per annum) spread over Years 2 and 3. In the event that the route does not operate for the full period, a 'clawback' mechanism will be required to repay the aid.
- Aid must be strictly linked to the allowable additional start-up costs directly incurred in launching a new route or adding frequency to an existing route i.e. exceptional costs rather than ongoing operating costs. Examples of allowable costs include route specific marketing and advertising costs and capital cost of additional facilities required at the regional airport. These costs must be 'real' i.e. those normally obtained under normal market conditions.
- Aid cannot be granted for standard operating costs related to the ongoing operation of the aircraft, fuel, catering, crew costs and airport charges.

Airport charges incentives can also be offered by the airport operator from its own resources as long as the operator is profitable and the incentives offered are transparent, non discriminatory, are proportional and have a supporting profitable business case.

For loss making airports receiving operating subsidies, it would be difficult to justify significant airport charges incentives to stimulate traffic without a realistic expectation of breaking even in a relatively short period.

Transparency and non-discrimination

Any available public start-up aid, whether via an airport or not, must be made public and with adequate publicity to alert all airlines of the availability of the aid. The publicity must include a description of the route and objective criteria to be used in awarding the amount and duration of aid.

Airlines must provide a business plan that shows the route reaching profitability over a 'substantial' period after the aid has expired.

Analysis of impact on existing routes is required before granting aid, as well as including an impact assessment study on existing competing routes (generally viewed as operating from the same airport).

Publicity, appeal and penalties

Member States must ensure that details of routes receiving aid are published on an annual basis for each airport. Appeal procedures must be provided at the Member State level to ensure there is no discrimination in the granting of aid.

A system for aid recovery must be in place in the event that a carrier fails to maintain any route operating undertakings given in relation to the aid.

Notification

Aid must be notified before it is allocated. Aid can only be granted if the EC has taken (or is considered to have taken) a decision authorising it. Notification must be submitted to DG Mobility and Transport via the Member State using standard State aid notification procedures.

If the EC has not taken a decision within the two months deadline, the aid is declared authorised. The Member State then informs the EC of its decision to implement the measure at which point the EC has fifteen working days to respond.

If the EC opens a formal investigation procedure, it must, after a process that is not limited in time, take a final decision:

- There is an absence of aid.
- There is aid which is compatible with the common market.

- There is aid which is incompatible with the common market.
- Approval of the aid subject to conditions.
- Illegality of the aid.

1.3.3 Subsequent approvals based on compliance with the Guidelines

Since the application of the Guidelines in 2005, only two schemes and around 6 route approval decisions have been granted by the EC. The most notable approvals concerned the 2006 Malta and 2009 Cyprus schemes.

1.3.4 EC timetable for revised Guidelines in 2011

When the Guidelines were published in 2005, the EC gave an undertaking to carry out a review within five years. The likely timetable for any revision to the Guidelines is as follows:

- Consultation to interested parties launched in Q1 2011.
- Review outcomes of consultation during Q2.
- Issue any revision to the Guidelines towards the end of Q3 2011.

We understand from our discussions with the EC that there are no major assessments of notified schemes at present. The EC acknowledges that other approaches are being adopted for public and private sector parties to work together to promote regions and encourage business and leisure tourism activity.

Until revised guidelines are issued in 2011, the 2005 Guidelines will be used as the basis for assessment of any future schemes submitted to the EC for approval.

1.3.5 Court of First Instance judgement on Charleroi decision (2008)

In December 2008, the Court of First Instance of the European Communities ("CFI") struck down the EC's 2004 Charleroi decision and ruled on the application of the private investor principle to the aviation sector.

The CFI held that in the Charleroi complaint, the Walloon Region and the airport company are a single economic entity for the purposes of applying the private investor principle.

The EC was required "when applying the private investor test, to envisage the commercial transaction as a whole in order to determine whether the public entity and the entity which is controlled by it, taken together, have acted as rational operators in a market economy." In treating the entities as separate, notwithstanding their financial links, the EC made an error of law which invalidated the decision.

The judgment confirms that the application of the private investor principle hinges not on the status of the body granting the measure, or on the means by which it provides that grant, but on the nature of the State's activity in adopting the measure.

In the aviation sector, future assessments of the nature of Member States' activities will need to consider the ownership of infrastructure and operation and management services, as a joint economic activity to which the principle would be applied.

The EC has acknowledged that while their Charleroi decision applied the market investor incorrectly, the CFI judgement was unlikely to directly impact on any future revision to the Guidelines. The EC is of the opinion that even if the Walloon Region and the airport company had been treated as a single

entity for the purpose of applying the private investor principle, it would not have altered the conclusion that a private investor would not have invested on the same basis. As such, the aid would be incompatible with the market.

1.4 Case Studies

Detailed case studies of three different types of public sector intervention to encourage airline route development were reviewed.

- **Pre Guidelines intervention** - Scottish Route Development Fund.
- **Guidelines compliant intervention** – Malta Air Route Development Scheme.
- **Market economy investor intervention** – Norrköping (Sweden) Air Route Risk Share Mechanism.

The case studies include a description of the scheme and its design process through to its implementation and 'post aid' route performance. The success of these schemes is discussed from a regional airport and route development perspective.

In each case, it is difficult to isolate specific factors in a growing aviation market coupled with the impact of the recent economic downturn. However, the historic performance would tend to indicate varying degrees of improvement in each of the case study route networks which may not have been achieved without public sector intervention to encourage the establishment of new routes.

1.5 Co-operative Marketing Approach

Tourism bodies across Europe have long standing programmes of co-operative marketing with a range of public and private sector partners to jointly invest in promoting regions to target inbound business and leisure tourism markets.

Whilst Directorate-General Transport and Mobility regulates the transport industry including the air transport sector, tourism policy falls within the remit of Directorate-General Enterprise and Industry.

The EU has no "competence" over tourism policy within Member States, but plays an increasingly active co-ordinating role in the tourism sector through a number of policies and initiatives.

This would suggest that there should be flexibility in the way that public and private sector parties can co-operate to promote the Western Region in key markets. Carefully structured co-investment in marketing activities by public and private parties provides the opportunity to follow the market economy investor principle thereby mitigating the risk of State aid related issues

Objectives of co-operative marketing

The objectives of a co-operative marketing approach must clearly relate to the tourism sector. There may be other wider economic and supply chain benefits from increased tourism activity. However the objectives must clearly relate to tourism to avoid confusion on the need for investment and which areas of EU policy apply. The primary objectives of tourism co-investment tend to:

- Encourage inbound tourism (the encouragement of outbound tourism is not an objective).
- Improve accessibility and competitiveness for the tourism sector by developing close links with partners to jointly market the country / region in identified markets.
- Encourage, improve or potentially safeguard access from key tourism markets.

Key principles

The key principles of co-operative marketing are to:

- Increase the visitor numbers from key markets.
- Increase tourism related revenue.
- Work with public and private sector entities to maximise the impact of marketing spend to encourage inbound flows from existing markets and new domestic and/or international markets.
- Comply with EU State aid principles.
- Make investment decisions on a rational and consistent basis.

Mechanism

Co-operative marketing mechanisms seek to establish and structure relationships between public and private sector entities with the aim of investing in the promotion in key inbound tourism markets that meet the investment appraisal criteria.

Investment by the public sector in marketing campaigns is generally in arrears, i.e. after the campaign has been agreed and launched. Depending on the campaign, investment can also be linked to a measurement of benefits e.g. number of additional visitors from a target market.

Private sector investment entities could include airports, ports, airlines, ferry companies, hotel groups or others with an economic interest in promoting increased tourism activity in the region.

Any investment provided should be on the basis of an agreed marketing campaign in the target market with agreed allocation of financial and/or other contributions to the campaign by the respective market partners.

The mechanism would be a time limited intervention for domestic and/or international markets that have the characteristics to add to the number of inbound tourists to the country/region.

The amount of funding allocated would be determined between the stakeholders and will depend on the market opportunities, objectives being sought and the likely timescales for investment.

1.6 Conclusions

- The EC has progressively reduced the flexibility for public sector financial support for air route development as a reaction to perceived market distortions.
- The 2004 Charleroi decision and 2005 EC Guidelines have effectively curtailed the type and levels of public sector support available to support air route development.
- The 2008 Court of First Instance judgement overturning the EC's Charleroi decision due to a failure to correctly apply the market economy investor principle is unlikely to directly impact on any future revision to the Guidelines.
- We understand that the forthcoming review of the Guidelines in 2011 is unlikely to significantly ease the restrictions on the potential operation of compliant route development funds providing start-up aid to airlines at regional airports.
- The process for developing a compliant scheme is straightforward with the EC's Guidelines setting out the detailed criteria required to gain approval.

- However, the relatively small number of notifications of compliant schemes illustrates the success of the Guidelines in restricting (rather than encouraging) development of new air services from regional airports.
- Whilst Directorate-General Transport and Mobility regulates the transport industry including the air transport sector, tourism policy falls within the remit of Directorate-General Enterprise and Industry.
- The EU currently has no “competence” over tourism policy within EU Member States, but plays an increasingly active co-ordinating role in the tourism sector through a number of policies and initiatives.
- Tourism bodies across Europe have long standing programmes of co-operative marketing with a range of public and private sector partners to jointly invest in promoting regions to target inbound business and leisure tourism markets.
- Development of a properly structured and administered tourism co-operative marketing approach would appear to offer more scope for innovative partnerships between private and public sector parties with the joint aim of promoting the Western Region in key inbound tourism markets.

2 Introduction and Context

2.1 Introduction

The Western Development Commission (“WDC”) is a statutory body promoting economic and social development in the Western Region (counties Donegal, Sligo, Leitrim, Roscommon, Mayo, Galway and Clare) (www.wdc.ie).

The WDC operates under the aegis of DCEaGA¹ and its remit is to promote, foster and encourage economic and social development in the Western Region. The WDC Strategic Plan 2010-2012 has five strategic goals:

- Inform policy-making on economic and social development in the Western Region through high quality analysis.
- Promote the benefits of living, working and doing business in the Western Region.
- Encourage the development of the rural economy based on the sustainable development of the Western Region’s strengths and resources.
- Provide risk capital to SMEs and social enterprises in their start-up and expansion phases through the WDC Investment Fund (“WIF”).
- Operate the WDC as a competent and effective organization.

One of the WDC’s main work areas involves the analysis of key policy issues affecting the development of the Western Region. The WDC is reviewing air access into the Western Region and wishes to gain a greater understanding of European Union (“EU”) regulations on State aid, in particular, the EU Community Guidelines on start-up aid for airlines departing regional airports and the application and experience of these rules and any alternative options.

2.2 Context

The Western Region has one State airport (Shannon) and four regional airports (Knock, Sligo, Galway, Donegal) providing a range of domestic and international flights, employment opportunities and supply chain benefits for the region. They also contribute to supporting the competitiveness of the region as well as providing convenient access for destinations served from the respective airports.

In recent years, many regions across Europe have been active in supporting the development of air services recognising air service development as a critical contribution to the:

- Competitiveness of businesses in the region.
- Attractiveness of the regions as a destination for establishing and conducting business for foreign direct investment (“FDI”).
- Continued development and accessibility of peripheral and relatively sparsely populated regions.
- Linkage with the regional economic development strategy.
- Promotion of inbound tourism (a key industry for the Western Region).

The need for good air services for the Western Region is widely recognised, particularly as the region is geographically peripheral on the edge of Europe and is relatively sparsely populated. The need for

¹ Department of Community, Equality and Gaeltacht Affairs.

good air services is discussed by the Committee of the Regions opinion² on the capacity of regional airports in reference to the case of peripheral, island and sparsely populated regions within the EU.

Various forms of public sector intervention to develop air services had been employed across Europe in recent years despite frequent complaints from established carriers. These complaints have tended to focus on the perceived level of financial support provided to low cost carriers in particular to incentivise them to commence new air services from regional airports.

These complaints initiated the European Commission's ("EC") investigation of potential State aid breaches resulting in their landmark 2004 decision³ on the complaint concerning advantages to Ryanair at Charleroi airport near Brussels. This decision enabled the EC to publish their 2005 Guidelines⁴ (the "Guidelines") on acceptable structures and levels of financial support for new air routes from qualifying airports.

Whilst the Guidelines have no legal force, they provide the basis for design of an acceptable public sector financial intervention for assistance to the development of European Community airports and support for new air services from these airports.

The EC's decision in the Charleroi complaint was challenged by Ryanair and subsequently overturned by the European Court of First Instance in December 2008⁵. This annulled the EC's 2004 decision which had deemed the advantages authorized by Belgium's Walloon Region and its airport, Brussels South Charleroi Airport ("BSCA"), to the airline to be illegal State aid.

The Court found that the EC should have applied the market economy investor principle ("MEIP") when it made its decision and due to a clear error in law on the part of the EC, the 2004 decision was annulled. The judgment also gives judicial guidance on State aid – even if it is very general guidance. In essence, incentives to attract airlines to use an airport are permissible provided they comply with the market economy principle. The incentives have to be limited in time, limited in terms of intensity (not all costs would be covered, particularly normal operating costs) and available on a non-discriminatory basis to reflect key State aid principles. This is discussed in more detail in Section 4.

The EC is expected to commence consultation with Member States and other stakeholders in spring 2011 and issue updated Guidelines later in 2011. However, based on informal discussions with an EC official, we do not expect fundamental changes to the revised Guidelines.

One of the other features of air services in the Western Region is the existence of public sector obligation ("PSO") funding routes from each of the airports to and from Dublin. The recent economic challenges in Ireland have raised the issue of continuing funding of the PSO routes at the historic levels. The improvement of road and rail access to Dublin in recent years from parts of the region is likely to be another factor in the ultimate decision on which routes would be eligible for PSO support in the future.

The restrictions imposed by the 2005 Guidelines have moved public and private sector partnerships towards a shared marketing approach. This is based on the market economy investor principle with

² COTER-019, 29th July 2003.

³ European Commission Decision concerning advantages granted by the Walloon Region and Brussels South Charleroi Airport to the airline Ryanair in connection with its establishment at Charleroi (2004/393/EC), 12th February 2004.

⁴ Community Guidelines on Financing of Airports and Start-up Aid to Airlines Departing from Regional Airports(2005/c 312/01), 9th December 2005.

⁵ Judgment of the Court of First Instance (State aid – Agreements entered into by the Walloon Region and the Brussels South Charleroi airport with the airline Ryanair – Existence of an economic advantage – Application of the private investor in a market economy test), Case T-196/04, 17 December 2008.

investment by the public sector, generally through tourism agencies, sitting alongside an airline and/or other private sector entities.

These activities do not fall within the competency of what was the EC's Directorate General Transport and Energy (DGTREN) now restructured as DG Transport and Mobility. Tourism related activities are regulated by the Directorate General Enterprise and Industry, whose role is primarily one of co-ordination rather than active participation. However, the overarching State aid rules will always apply.

2.3 Objectives

The objectives of the report (the "Report") are to:

- Outline the various steps required in submitting an application to gain EU approval for aid for route development from 'regional' airports, with particular reference to the EC Guidelines.
- Describe how the Guidelines operate in practice and examples of 'best practice' in devising a scheme for EU approval.
- Outline the likely process, within an Irish context, for application and administration of a compliant scheme, and sets out the roles of all relevant stakeholders.
- Identify case studies of a similar scheme in operation and an alternative option for supporting route development as well as examining the 'post aid' performance of these schemes.

2.4 Report Structure

The Report is structured as follows:

Section 2 outlines the context of the work and the objectives of the Report.

Section 3 provides an overview of State aid general principles, assessment of aid and notification requirements

Section 4 reviews how State aid assessment has historically been applied to assessing support for air routes. It sets out the current position to reflect recent EC decisions and discussion of the Court of First Instance's 2008 judgement overturning the EC's Charleroi decision. Finally, a summary of the planned review of the 2005 Guidelines is included based on informal discussions with an EC official.

Section 5 provides detail on the Guidelines requirements for the provision of start-up aid to airlines, how the process operates in practice, specifying the various steps which should be undertaken to apply for and gain EU approval including indicative timescales.

The likely roles and responsibilities of the key stakeholders in Ireland are outlined in the design and operation of a compliant route development scheme.

Section 6 reviews case studies of a start-up aid approval in compliance with the EC Guidelines as well as a market economy based approval, and the steps undertaken by the various stakeholders from initial consideration of the scheme to granting of EC approval. A pre-Guidelines case study of a successful route development scheme is also included.

The case studies include a description of the scheme, its design process through to its implementation as well as 'post aid' route performance. They outline the performance of the schemes from a regional airport and route development perspective.

Section 7 sets out the basis for an alternative co-operative tourism marketing approach based on the market economy investor principle.

Section 8 includes a summary of conclusions on the key issues and how to effectively work with private sector parties to support development of inbound tourism markets.

3 State Aid Overview

3.1 Introduction

This section provides an overview of State aid general principles, assessment of aid and notification requirements.

3.2 Background to State Aid

State aid rules are in place to prevent the use of public sector funding to distort or threaten to distort competition, or affect trade between Member States by favouring certain parties.

Article 87(1) of the Treaty establishing the European Community (the "Treaty") provides that State aid is, in principle, incompatible with the common market. Article 88 gives the European Commission (EC) the task to control State aid. The Treaty then allows exceptions for certain aid such as aid to make good damage by natural disasters or exceptional occurrences.

State aid rules apply only to measures that satisfy all of the criteria listed in Article 87(1) of the Treaty, in particular:

- **Transfer of State resources**

State aid rules cover only measures involving a transfer of state resources (including national, regional or local authorities, public banks and foundations, etc.). The aid does not necessarily need to be granted by the State itself. It may also be granted by a private or public intermediate body appointed by the State.

Financial transfers that constitute aid can take many forms: not just grants or interest rate rebates, but also loan guarantees, accelerated depreciation allowances, capital injections, tax exemptions etc.

- **Economic advantage**

The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business. Less obvious examples of transactions satisfying this condition include:

- A firm buys/rents publicly owned land at less than the market price.
- A company sells land to the state at higher than market price.
- A company enjoys privileged access to infrastructure without paying a fee.
- An enterprise obtains risk capital from the State on terms, which are more favourable than it would obtain from a private investor.

- **Selectivity**

State aid must be selective and affect the balance between certain firms and their competitors. This "selectivity" differentiates State aid from "general measures" i.e. measures which apply without distinction to all firms in all economic sectors in a Member State e.g. most national fiscal measures.

A scheme is considered "selective", if the authorities administering the scheme have a degree of discretionary power. The selectivity criterion is also satisfied if the scheme applies to only part of the territory of a Member State, which is the case for all regional and sectoral aid schemes.

- **Effect on competition and trade (and de minimis aid)**

Aid must have a potential effect on competition and trade between Member States. It is sufficient if it can be shown that the beneficiary is involved in an economic activity and that it operates in a market in which there is trade between Member States. The nature of the beneficiary is not relevant in this context (even a non-profit or State owned entity can engage in economic activities).

The EC has taken the view that small amounts of aid (“de minimis aid”) do not have a potential effect on competition and trade between Member States thereby falling outside the scope of Article 87(1) of the Treaty. Public funding or support (e.g. grants, loans, subsidised contracts etc.) from all public sources provided specifically as de minimis funding to a single recipient up to €200,000 over a 3 year fiscal period does not require notification. This aid can be given for most purposes, including operating aid and is not project related.

The recipient must confirm the amount of any aid received during the previous 3 years and how much of this was de minimis aid. The recipient must be informed explicitly that the aid is de minimis aid, for their future reference. The offer letter should include the value of the award in Euros.

3.3 Compatible State Aid

According to Article 87(1) of the Treaty, aid measures that satisfy all the above criteria are, in principle, incompatible with the common market. However, the principle of incompatibility does not amount to a full-scale prohibition.

Articles 87(2) and 87(3) of the Treaty specify a number of cases in which State aid could be considered acceptable (the “exemptions”). The existence of these exemptions also justifies the vetting of planned State aid measures by the EC as outlined in Article 88 of the Treaty.

Article 88 requires Member States to notify the EC of any plan to grant State aid before putting it into effect. It also gives the EC power to decide whether the proposed aid measure qualifies for exemption or whether the “State concerned shall abolish or alter such aid”.

For the majority of State aid cases, the most relevant exemption clauses are those relating to regional aid and covered by Article 87(3)(a) and 87(3)(c) of the Treaty outlined below.

The EC has developed specific approaches depending on the size of the firm, its location, the industry concerned, the purpose of the aid, etc. and has made public the criteria it uses when deciding whether aid measures notified to it qualify for exemption. These publications have taken the form of regulations, “communications”, “notices”, “frameworks”, “guidelines”, and letters to Member States⁶.

The EC’s 2005 Guidelines on financing of airports and start up aid to airlines operating from regional airports are an example of such an approach setting out requirements for exemption. The Guidelines are discussed in detail in Section 5.

There are three main aid categories under Articles 87(3)(a) and 87(3)(c) of the Treaty:

- **Regional aid**
 - Articles 87(3)(a) and 87(3)(c) of the Treaty both provide a basis for the acceptance of State aid measures aimed at tackling regional problems:
 - Article 87(3)(a) of the Treaty applies to State aid to promote the development of “areas where the standard of living is abnormally low or where there is serious underemployment”.

⁶ All relevant regulations, communications, notices, frameworks and guidelines are available on the DG Competition web site: http://ec.europa.eu/competition/state_aid/legislation/legislation.html

- Article 87(3)(c) of the Treaty covers aid to other types of (national) problem regions “aid to facilitate the development of ... certain economic areas”. This article gives Member States the possibility to assist regions which are disadvantaged compared to the national average. The list of regions qualifying for this exemption is also decided by the EC, based on a proposal by individual Member States.
- **Other horizontal rules**

Cross-industry or “horizontal” rules set out the EC’s position on particular categories of aid aimed at tackling problems which may arise in any industry and region. To date, the Commission has adopted “frameworks”, “guidelines” or “block exemption regulations” setting out the criteria that are to be applied to the following categories of aid:

 - Aid for climate change and for other environmental protection.
 - Aid for research and development and innovation.
 - Aid for the rescue and restructuring of firms in difficulty.
 - Aid for small and medium-sized enterprises.
 - Aid to employment.
 - Training aid.
 - Aid for risk capital.
 - Aid for services of general economic interest.
- **Sectoral rules**

The EC has also adopted industry-specific or “sectoral” rules defining its approach to State aid in particular industries. The most relevant in the context of this Report is the transport sector where sector-specific State aid rules apply to the air industry. This is discussed in detail in Section 4.

3.4 Specific Aid Instruments

For the use of specific aid instruments such as guarantees, fiscal aid, capital injections, or for the calculation of the aid content of a measure, guidance has been provided through the publication of a number of notices available at the EC’s DG Competition website site.

3.5 Basic Methodology for State Aid Assessment

The assessment of aid compatibility is a “balancing test” of the positive effects of aid contribution to the achievement of a well-defined objective of common interest and its negative effects from the resulting distortion of competition and trade. In order to be declared compatible, aid must be necessary and proportionate to achieve a particular objective of common interest.

This approach does not mean that every State aid case undergoes a specific in-depth assessment. The least distortive cases (de minimis aid) are not considered to be State aid. For such aid, there is no requirement to use the “Formal Prior Notification Procedure”. However, the aid grantor must:

- Inform the recipient that the aid concerned complies with the “de minimis” regulation.
- Record details of such aid and retain for at least 10 years

- Confirm from the recipient that the total of de minimis aid received does not exceed €200,000 in a rolling three year period.

Cases for which it is possible to design easily applicable sets of compatibility criteria are exempted from the notification requirement. This is known as the General Block Exemption Regulation (GBER).

The next level, the standard assessment, allows the EC to assess most cases through predefined conditions (including set aid intensities) which aim to ensure the proportionality and necessity of the aid and its limited distortive effects and are reflected in the legal assumptions of the rules.

The last level of control - the detailed assessment - is applied for the potentially most distortive cases where the EC verifies the economic rationale of the aid on a case by case basis. Financial aid to the aviation sector related to new air services will generally fall into this category of control.

Level of Control	Assessment
1	No aid – De minimis
2	General Block Exemption Regulation (GBER)
3	Standard assessment
4	Detailed assessment

Table 1 - Graduation of the assessment

3.6 Standard and Detailed Assessments

The basic element of the more refined economic approach in level of control 3 and 4 outlined above is the balancing test, a cost-benefit analysis of the proposed measure testing the following components:

- **Well-defined objective of the common interest**

Aid should be aimed at a well-defined objective of a common interest (such as growth, employment, cohesion, environmental protection, etc). This can include both efficiency and equity objectives.

The efficiency objective aims at correcting a market failure (e.g. externalities, imperfect information, coordination problems). Route development funds typically use the market failure argument to justify use of public funds to promote air services.

The equity objectives can include, for example, the employment of disabled workers, or encouraging firms to set up factories in disadvantaged regions. In some cases aid can also be authorised to promote the transition to better functioning markets.

- **Well-designed instrument**

The basic issue here is to ensure that the aid is designed to deliver the objective of the common interest identified above. To do that, the answers to the following three questions will be crucial:

Is the aid an appropriate policy instrument? - State aid should be used where the advantages of using a selective instrument (such as State aid) are established and demonstrated.

Is there an incentive effect? - does the aid change the behaviour of the beneficiary? The beneficiary should, as a result of the aid, engage in activities that it would:

- Not carry out without the aid at all; or

- Carry out only in a restricted or different manner.

The aim is to avoid State aid for an activity which the company would undertake without the aid e.g. if an air route would commence without any support.

Is the aid measure proportionate to the problem tackled? – could the same change in behaviour have been achieved with less aid? The amount and intensity of the aid must be limited to the minimum necessary for the activity to take place. Normally, aid is deemed proportional if the maximum aid intensities set by legislation are followed.

To perform the analysis, the EC must identify a “counterfactual scenario” to compare the aided project with a hypothetical situation that no aid was given to analyse some of the objectives of the common interest (e.g. a market failure) and the incentive effect i.e. did the behaviour of the beneficiary change?

- **Balancing of the positive and the negative effects/overall balance positive**

This addresses the possible negative effects of the aid and their magnitude against which its positive effects are balanced. The negative effects are primarily distortive effects on competition and trade which may include prevention of exit and keeping inefficient firms afloat, crowding out of private investment, disrupting dynamic incentives, costs of State aid linked to fiscal spending, etc.

For the aid to be found compatible, a high magnitude of negative effects needs to be sufficiently offset by a corresponding high level of positive effects of the aid. The effects on both sides of the equation should be expressed both in qualitative and, where possible, quantitative terms.

The EC will make an overall assessment of their impact on producers and consumers in the markets affected by the aid measure. The overall outcome will depend on a series of features of the proposed aid measure and will be assessed on a case by case basis for measures subject to the detailed assessment.

3.7 Notification and Authorisation Procedures

Member States are required to inform the EC of any plan to grant or alter State aid and are not allowed to put such aid into effect before it has been notified and authorised by the EC. Any aid, which is granted in the absence of EC approval, is automatically classified as “unlawful aid”.

The EC is obliged to order the recovery from the beneficiaries of any unlawful aid found to be incompatible with the common market.

In recent years, the EC has started a process of modernisation and simplification of State aid procedures. The “block exemption regulations” allow the EC to declare some categories of State aid compatible with the Treaty if they fulfill certain conditions, thus exempting them from the requirement of prior notification and Commission approval.

In 2008, a new General Block Exemption Regulation (“GBER”) was adopted which introduced further new types of measures which are exempted from the notification obligation. As a result, Member States are able to grant aid that meets the conditions laid down in the GBER without the need for giving prior notification to and securing EC agreement. The GBER cannot be used for aid given to support air routes.

Individual aid measures or aid schemes that satisfy all the conditions laid down in the GBER do not need to be notified. The Member State is required to submit to the EC a summary description of the aid measure within 20 working days following implementation of the measure.

As previously stated, where the aid measure satisfies all of the conditions in the de minimis Regulation, there is no requirement to submit summary information. Member States are obliged to monitor such aid in line with the de minimis Regulation.

For measures exempted from notification under the GBER, the Member States also have an obligation to publish on the internet the full text of the measure and keep it posted as long as the measure is in effect.

3.8 Notification Process

For aid requiring approval, the Member State (central department) must notify the planned aid measures, through their Permanent Representation in Brussels. To speed up the process, the EC provides standard notification forms for most types of aid. Dedicated software ("SANI") has been developed for Member States to facilitate and accelerate the notification process.

Some minor alterations to existing aid are subject to a simplified system of notification and a faster decision making procedure as long as the EC has been regularly informed on the implementation of the existing aid concerned.

- **Request for additional information**

If the notification is incomplete, the EC will request further information with the Member State usually given 20 days to supply this information.

- **Examination and decision**

The EC has two months to examine the proposed aid. The two month period runs from the date the EC has received all of the information it needs to assess the case and the notification can be considered to be complete. This examination will normally be concluded either by a decision not to raise objections, or by a decision to initiate Article 88(2) proceedings.

If the EC decides not to raise any objection, the aid measure can be implemented.

However, if it has doubts about the compatibility of the notified aid measure with the common market the EC initiates Article 88(2) proceedings and opens a "formal investigation" e.g. their investigation of the Charleroi complaint.

The EC publishes a description of the aid in the Official Journal and on its website and invites the Member State concerned and interested parties to comment. At the end of the enquiry, the EC adopts a final decision. This may be either positive (aid can be implemented), negative (aid cannot be implemented) or positive, but subject to stated conditions (aid can be implemented if certain conditions are met). The indicative maximum time-limit foreseen for such an enquiry is 18 months.

All decisions are subject to review by the European Court of Justice under Article 230 of the Treaty. National courts also play a role with respect to enforcement of EC recovery decisions.

3.9 Risk Capital

The EC's risk capital guidelines enable the State to provide equity financing of SMEs with perceived high-growth potential during their early growth stages. The demand for risk capital typically comes from companies with growth potential that do not have sufficient access to capital markets, while the offer of risk capital comes from investors ready to take high risk in exchange of potentially above average returns from the equity invested. The General Block Exemption Regulation also provides scope for risk capital schemes.

3.10 Market Economy Investor Principle (MEIP)

If the State is acting in a way that a private investor would in a market economy, for example in providing loans or capital on terms that would be acceptable to a private investor, it is not providing State aid within the meaning of Article 87(1).

The general rule is that the investment should be on equal terms with the private investor (50/50). The onus is on the Member State to be able to demonstrate, if challenged, that the funding is on genuinely commercial terms, and the public sector is accepting the same risks and returns as the private sector.

4 State Aid in the Aviation Sector

4.1 Introduction

This section provides an overview of how State aid assessment has historically been applied to assessing support for air routes. It sets out the current position to reflect recent EC decisions and discussion of the Court of First Instance's 2008 judgement overturning the EC's Charleroi decision. Finally, a summary of the planned review of the 2005 Guidelines is included based on informal discussions with an EC official.

4.2 Overview of EC Position on State Aid to Airports and Route Start-up Aid to Airlines

Until recently, aviation activity within the EU was regulated by Directorate-General for Transport and Energy (DGTREN), whose role was to develop EU transport and energy policies, including dealing with State Aid related issues.

DGTREN has subsequently been reorganised to become Directorate-General for Mobility and Transport with the role of regulating the transport industry including the air transport sector. As part of the reorganisation, the State aid unit previously within DGTREN relocated to Directorate-General Competition (DG COMP).

The EC has continuously developed its position on the existence of State aid to airports and start-up aid to airlines. Relevant developments include the 1998 decision relating to Manchester Airport, the 2004 decision on the complaint relating to advantages to Ryanair at Charleroi Airport and the resulting 2005 guidelines on financing of airports and start-up aid to airlines operating from regional airports (the "Guidelines").

A number of approvals have been granted to schemes developed around the Guidelines requirements. However, the EC received a setback in December 2008 when the Court of First Instance ("CFI") upheld Ryanair's appeal relating to the EC's 2004 Charleroi decision.

The EC has subsequently announced a review of the 2005 Guidelines, partly as a result of the CFI judgment and partly to fulfill its commitment within the Guidelines for a review. This is expected to take place during 2011.

4.2.1 Manchester decision (1999)⁷

The complaint (by Mobberley Parish Council) had a number of strands with the major aspect relating to Continental Airlines receiving unfair financial advantage from a scheme to provide reduced airport charges. In particular, Continental Airlines would benefit from a reduction on landing fees as well as from Manchester Airport's commitment to refund the airline's losses, if any, on the Manchester-Newark route in the form of reduced passenger fees. According to the complaint, this agreement would infringe Article 87.

The EC recognised that granting discounts on landing fees to airlines is a standard commercial practice that airports use to encourage new service and attract new customers. If the airport manager is a public entity, the revenue given up by offering airport charges rebates amounts to State resources and the question arises whether such measures come within the meaning of Article 87. If a discount or a system of discounts is designed to give preferential treatment to a specific undertaking, then Article 87 may apply.

The EC had to assess whether the measures distort competition and affect trade between Member States. The EC found that the discounts did not fall within the meaning of Article 87 because of the way they were designed, the measures being of limited duration and they did not discriminate between the users of the airport infrastructure.

⁷ State aid No NN 109/98 - UNITED KINGDOM, Manchester Airport. European Commission, 14th June 1999.

In addition to the discount on landing fees, the arrangement included a second type of incentive in the form of a potential reduction on passenger fees. This was aimed at compensating for losses, if any, that Continental Airlines could have suffered during the start-up period. Because the service was profitable from the start, this potential discount was never granted in practice. The EC found that this measure entailed a potential transfer of State resources for the exclusive benefit of Continental Airlines. As such it might have fallen within the meaning of Article 87 and should be considered as being un-notified aid requiring an in-depth assessment by the EC. However, the arrangements expired without this potential aid being ever paid and were no longer an issue.

The EC's decision relating to the Manchester complaint effectively endorsed the concept of public sector funding contributions to new air services provided the funding did not distort competition, was transparent, non discriminatory, proportionate to the objective being sought and limited in duration.

4.2.2 Charleroi decision (2004)

The EC received a complaint (from an undisclosed party) in January 2002 that Belgium had granted a number of advantages to Ryanair for the operation of air services at Charleroi Airport, by Brussels South Charleroi Airport ("BSCA"), the airport's managing body, and the Walloon Region (Belgium)⁸.

The Walloon Region granted Ryanair a preferential rate for landing charges at Charleroi of €1 per boarding passenger (circa 50% of the standard rate) - no other airline benefited from this rate.

BSCA, a public undertaking owned and controlled by the Walloon Region, also granted various types of advantages to Ryanair:

- Contribution towards promotional activities of €4 per boarding passenger, over 15 years and for up to 26 flights daily - no other airline benefited from this.
- Initial incentives amounting to €160,000 per new route opened for 12 routes (€1,920,000 in total); €768,000 in reimbursements for pilot training; €250,000 for hotel accommodation costs - no other airline benefited from this.
- Preferential rate of €1 per passenger for ground handling services (rates normally charged to other airlines was €8-13) - no other airline benefited from this.

The EC had to determine whether the measures taken in favour of Ryanair by the Walloon Region and BSCA were in keeping with the market economy investor principle.

This would require the advantages to be granted on the basis that the public undertaking is guided by the same objectives of long-term profitability as a comparable private firm. This principle helps ensure equal treatment between public-sector operators, such as BSCA, and private firms.

The EC concluded that no private operator in the same circumstances as BSCA and the Walloon Region would have granted the same advantages due to:

- The level of expected profits over a period of 10 to 15 years having considered the revenue and cost assumptions in the business plan.
- The extent and nature of the associated risks.
- Lack of formal guarantees from the Walloon Region regarding the continuity of fire and maintenance compensation and capping of contribution to the Environment Fund.

⁸ COMMISSION DECISION concerning advantages granted by the Walloon Region and Brussels South Charleroi Airport to the airline Ryanair in connection with its establishment at Charleroi, (notified in Number C(2004) 516) (2004/393/EC). European Commission, 12th February 2004.

Since the market economy investor principle was not adhered to in this case, the advantages granted to Ryanair alone and for a long period without transparency were deemed to constitute State aid which could distort competition in favour of Ryanair. The main areas of aid deemed to be granted to Ryanair which did not meet the transparency, non discrimination and proportionality requirements were:

- Reductions in airport landing charges.
- Discounts on ground handling services.

The EC decision pointed out that the aid was operational aid which did not constitute investment in airport infrastructure and could not be deemed compatible with classic instruments of Community law such as regional development aid.

The EC considered that some of the aid granted to Ryanair may be compatible with the common market in the context of transport policy⁹, insofar as it fosters the development and improved use of secondary airport infrastructure which is currently underused and represents a cost to the community as a whole¹⁰. The decision allowed Ryanair to keep part of the aid¹¹ including:

- Marketing contributions for the promotion of a new route.
- One-shot incentives directly linked to the establishment of a new route.
- Provision of office space.

BSCA's contribution to the financing of a joint promotion and publicity company with Ryanair, which could be considered to be aid to the start-up of new air routes on the basis that it encourages better use of regional airports, in keeping with the Community's objective for air transport.

For such aid to be authorised, the Belgian authorities had to ensure that it met the following conditions:

- It must be **necessary for the opening of new routes**, serve as an **incentive**, be **proportional** to the objective pursued, be granted with due regard for the principles of **transparency**, equal treatment and **non-discrimination** between operators, be accompanied by a mechanism for **imposing penalties** should the carrier fail to comply with his commitments, and it must not be aggregated with aid which serves a social objective or with public service compensation payments.
- It must be of **limited duration** (five years in the case of point-to-point European routes, and not 15 years as per the original agreement) and correspond to a **maximum intensity of 50%** of the net start-up costs incurred, and the airport must have control over such costs and the aid must be available in the future to **any airline** which is established at Charleroi. This being the case, Ryanair could also be granted similar aid in the future, albeit limited to five years in each case, for the opening of new routes excluding routes which replace previously operated routes.

⁹ By reference to Article 87(3)(c) of the EC Treaty: '*The following shall be compatible with the common market: ... 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*'.

¹⁰ Such development benefits the regions by ensuring a better return from existing public goods and facilitating regional economic development, in particular through job-creation and tourism; it benefits the Member State concerned by encouraging spatial planning and better use of existing airports as opposed to the construction of new infrastructure or extensions; and it benefits the European Union whose need to develop airport capacity was pointed out in the White Paper on Transport and which provides part of the financing for airports through its regional policy, the TENs and the EIB.

¹¹ The decision is complex with the details set out in a document extending to 62 pages.

The EC positioned the decision as having major significance for the future of air transport by ensuring full and fair competition between carriers operating out of regional airports for the maximum benefit of consumers.

At a high level, the Charleroi decision authorises certain forms of aid that permit genuine development of new routes under clearly defined conditions. However, other direct aid granted by the Walloon Region and partly by the airport (a public undertaking controlled by the Walloon Region) was deemed incompatible with the proper functioning of the internal market and would have to be repaid by Ryanair as the recipient of the aid.

The Charleroi decision appeared to reinforce the Manchester decision with a detailed articulation of the principles of how public sector investment can be used to develop new routes from airports:

- Marketing support for the establishment of a new route is allowed for a limited duration (up to 5 years), where support can be proven to have been directly spent on marketing that particular route, and where support is proportional to the objective being pursued - rather than acting as a general operating subsidy.
- Discounted airport charges are allowed, again for a limited duration, but must be fully transparent and not structured to favour one carrier over another.
- Discounts on other aviation-related activity, including ground handling, must also be transparent and must relate to the cost of service provision. Cross-subsidy from commercial income-generating activities may also be taken into account under certain circumstances.

4.2.3 EC Guidelines on Financing of Airports and Start Up Aid to Airlines Operating from Regional Airports (2005)

Following the Charleroi decision, the EC undertook to issue clear guidelines during 2004 on the structure of public sector support for new air services. Draft guidelines were subsequently issued for a short period of consultation on 8th February 2005 with responses requested from interested parties by early March 2005. The EC published the Guidelines in December 2005.

A detailed review of the Guidelines is included in Section 5.

Subsequent approvals based on compliance with the Guidelines.

Since the application of the Guidelines in 2005, only two schemes and around 6 route approval decisions have been granted by the EC for compliant route development schemes. The most notable approvals concerned the 2006 Malta¹² and 2009 Cyprus¹³ schemes. The Malta scheme is discussed in detail later in Section 6.

Court of First Instance judgement on Charleroi decision (2008)¹⁴

In December 2008, the Court of First Instance of the European Communities (“CFI”) struck down the EC’s 2004 decision related to the Charleroi complaint and ruled on the application of the private investor principle to the aviation sector.

As previously outlined, the private investor principle provides that a measure is not an unlawful state aid under Article 87 where it confers on the State a benefit equivalent to that which a private investor might have obtained under a commercial arrangement.

¹² Air Route Development Scheme for Malta, State Aid No N640/2006, Malta. European Commission decision, C(2006) S490 final, 22nd November 2006.

¹³ Air Route Development Support Scheme 2008-2012, State Aid No N52/2008, Cyprus. European Commission decision, 18th March 2008.

¹⁴ Case T-196/04 Ryanair v Commission (State aid – Agreements entered into by the Walloon Region and the Brussels South Charleroi airport with the airline Ryanair – Existence of an economic advantage – Application of the private investor in a market economy test). Judgment of the Court of First Instance, 17 December 2008.

The CFI confirmed that, in determining whether a measure affecting the aviation sector breaches Article 87, it is not lawful to separate the provision of airport infrastructure and airport management services, for the purposes of applying that principle. Both are to be considered economic activities, to which the principle requires to be applied.

The CFI held that in the Charleroi complaint, the Walloon Region and the airport company are a single economic entity for the purposes of applying the private investor principle. It noted the company was economically dependent on the Region, it being a public undertaking 96.28% of whose share capital is public capital. The Region not only participated in the Company's activities, but potentially also obtained financial consideration for having granted the measures in issue to Ryanair.

The EC was required "*when applying the private investor test, to envisage the commercial transaction as a whole in order to determine whether the public entity and the entity which is controlled by it, taken together, have acted as rational operators in a market economy.*" In treating the entities as separate, notwithstanding their financial links, the Commission had made an error of law.

The judgment confirms that the application of the private investor principle hinges not on the status of the body granting the measure, or on the means by which it provides that grant, but on the nature of the State's activity in adopting the measure.

In the aviation sector, future assessments of the nature of Member States' activities will need to consider the ownership of infrastructure and operation and management services, as a joint economic activity to which the principle would be applied.

4.2.4 EC timetable for revised Guidelines in 2011

An informal discussion was held with a member of the Transport State aid team now located in Directorate-General for Competition¹⁵, to assess the current thinking and timetable for consultation on potential revision of the Guidelines.

The EC has acknowledged that while their Charleroi decision applied the market investor incorrectly, the CFI judgement was unlikely to directly impact on any future revision to the Guidelines due to the technical nature of the judgement in failing to properly apply the private investor principle. The EC is of the opinion that even if the Walloon Region and the airport company were treated as a single entity for the purpose of applying the private investor principle, it would not have altered the conclusion that a private investor would not have invested on the same basis. As such, the aid would be incompatible with the market.

Areas of potential amendment informally discussed with the EC were as follows:

- **Simplification** – recognition that the Guidelines were overly complicated with relatively few submissions for EC approval received since the Guidelines were launched in 2005.
- **Financing of infrastructure** – may be some further flexibility for regional airports.
- **Financing of loss making airports** – public subsidy should only be used for operating expenses and should not be used for significant route incentives. This is a circular argument as without being proactive to incentivise new traffic, throughput volumes may never get to a level where the airport can break even.
- **Incentives to support future profitability** – wider economic benefit argument of financial support offered by a publicly owned airport (or privately owned airport in receipt of infrastructure

¹⁵ Telecon on 22nd November 2010.

and/or operating subsidies) unlikely to be justified unless there was a reasonable expectation that the airport could be profitable in a short period.

- **Market economy investor principle** – generally supportive of co-operative marketing arrangements as public and private entities can be demonstrated to have invested in promotion on an equal basis. Some concerns on marketing arrangements tied to only one airline and the actual imputed value of buying marketing space and customer contacts from a single airline. Where there are a number of carriers with the ability to participate on an equal basis then there is less concern

Since moving to Directorate General for Competition (“DG Comp) from DG Transport, the Transport State aid unit competence has become less specific. It is adopting a “one size fits all” approach to reflect the increased workload from carrier restructurings and the current spate of airport complaint and counter complaint from airlines to DG Comp.

The likely timetable for any revision to the Guidelines is as follows:

- Consultation to interested parties launched in Q1 2011 to focus on:
- How have the Guidelines worked in practice?
- What lessons have been learned?
- Have they met the objectives sought by their introduction?
- How could they be improved?
- Are they still required?
- Can they be adapted to encourage airlines to invest in route start-up?
- Review outcomes of consultation during Q2.
- Issue any revision to the Guidelines towards the end of Q3 2011.

We understand from our discussions with the EC that there are no major assessments of notified schemes at present. The EC acknowledges that other approaches are being adopted for public and sector parties to work together to promote regions and encourage business and leisure tourism activity.

Until revised guidelines are issued in 2011, the 2005 Guidelines will be used as the basis for assessment of any future schemes submitted to the EC for approval.

5 EC Guidelines and Approvals Process

5.1 Introduction

This section provides detail on the Guidelines requirements for the provision of start-up aid to airlines, how the process operates in practice, specifying the various steps which should be undertaken to apply for and gain EU approval including indicative timescales.

The likely roles and responsibilities of the key stakeholders in Ireland are outlined in the design and operation of a compliant route development scheme.

5.2 EC Guidelines Overview

The EC's Guidelines¹⁶ were published in December 2005 by Directorate-General for Transport and Energy (DGTREN), whose role was to develop EU transport and energy policies, including dealing with State Aid related issues.

DGTREN has subsequently been reorganised to become Directorate-General for Mobility and Transport with the role of regulating the transport industry including the air transport sector. As part of the reorganisation, the State aid unit previously within DGTREN relocated to Directorate-General Competition (DG COMP).

In the Guidelines, public sector funding of air routes meeting strict criteria is justified on the basis of helping regional airports to become financially sustainable through growing the passenger throughput.

The EC justifies its decision to restrict aid to routes departing from smaller airports on the basis that larger airports are financially sustainable and should not require any form of financial aid.

The main objective of the Guidelines is to regulate the scope, amount and duration of public sector funding relating to start-up of new services, or increasing frequency of existing services. It should be noted that the Guidelines do not have any legal status:

“..... they set out, for information purposes the Commission's general interpretation of these issues at the time of drafting. This is purely indicative, and without prejudice to the interpretation of this concept by the Court of Justice and the Court of First Instance.”

5.3 Background

The Guidelines are clearly aimed at regulating abuse of competition rules relating to public sector aid to low cost carriers in recent years. There had been a number of complaints to the EC, particularly from full service carriers, relating to public sector start-up aid for new services by low cost carriers.

The Guidelines apply to all airport activities, with the exception of safety, air traffic control and any other activities for which a Member State is responsible as part of its official powers as a public authority, whether it actually carries out the activities or not. This implies that any public funding of any incremental costs in these areas related to new services or increased frequency on existing services cannot be regarded as being State aid. Services provided by the State could include air traffic control, fire service, security etc. and cannot be deemed to be State aid.

The EC introduced a simple airport passenger throughput criterion as the proxy for market competition and eligibility for the receipt of public aid:

- Category A: airports above 10 million passengers cannot receive any new route start-up aid.
- Category B: airports between 5 and 10 million passengers are ineligible for aid unless exceptional cases can be made such as for routes from airports considered to be located in outermost or economically disadvantaged regions of the Community.

¹⁶ Community guidelines on financing of airports and start-up aid to airlines departing from regional airports, (2005/C 312/01). European Commission, 9th December 2005.

- Category C: airports between 1 and 5 million passengers per annum are eligible for aid (Shannon Airport).
- Category D: airports with less than 1 million passengers per annum are eligible for aid (Knock, Galway, Sligo and Donegal Airports).

Underlying the concept of time limited start-up aid as opposed to ongoing operating subsidy, there is a need for new services to become financially self-sustaining within a reasonable period. To ensure transparency of all aid, there is a mandatory requirement for all proposed aid to be notified to the EC for approval in advance.

5.4 The Need for Aid

The Guidelines claim to welcome start-up aid provided to airlines in the form of incentives to share the risk of starting new routes from regional airports (in reality, most of the financial risk sits with the carrier).

This is positioned as a mechanism to increase passenger volumes at regional airports and therefore their financial viability in the long run. There is also recognition by the EC that the larger carriers have concentrated their services at congested hub airports where investment in facilities has also been focussed over the years. This is one of the main reasons why the EC can approve public aid paid to airlines, under certain conditions, if it is time limited and contributes to the airport breaking even within a foreseeable period.

Increases in air services are also in line with wider Community aspirations for better economic and social integration of all regions of the Community, with developing regional airports contributing to various EU policies:

- Increased use of regional airports helps to reduce congestion at the major European hubs.
- More access points for intra-European flights increases the mobility and integration of European citizens.
- Developing regional airports helps to develop the competitiveness of the regional economies that the airport serves.

Increased levels of aid are allowed for services from airports in Europe's 'outermost regions'¹⁷ thus favouring their development, their integration into the Community, and also their relationships with neighbours (including countries in the Americas, the Caribbean and Africa) outside of the EU 25.

The EU has nine outermost regions that are geographically distant from the European continent but still form an integral part of the EU member countries they belong to. These regions are covered by EU law and the other rights and duties associated with EU membership – in contrast to overseas territories, which have a different legal status. The current outermost regions are:

- French départements – Martinique, Guadeloupe, French Guiana, Réunion, Saint-Barthélemy, and Saint-Martin ("collectivités d'Outre-mer").
- Portuguese autonomous regions – Madeira and the Azores.
- Spanish autonomous community – the Canary Islands.

¹⁷ http://ec.europa.eu/regional_policy/themes/outermost/

In Scotland, although Highlands and Islands airports serve remote island communities, these are not considered outermost regions.

In line with broader EU transport policy, if a proposed new route would operate in competition with a high-speed rail link, then public sector funding of the air route cannot be approved. This is unlikely to be an issue for the Western Region as there are no high speed rail links providing access to international markets.

5.5 Notification Requirements of Aid Schemes

The EC has a number of concerns relating to the provision of public funding for new air services. The main concern is that aid can lead to distortion of competition between airports and between airlines.

The EC makes a broad interpretation of this distortion. In the Charleroi complaint, they considered that as soon as public funds reinforce the position of one company at the expense of competitors, exchanges are affected and there is a distortion of the market.

The Guidelines therefore require the notification of any route incentive measure and it subjects these measures to a large number of conditions.

5.6 The Market Economy Investor Principle

The EC recognises the principle of the private investor in a market economy and that public sector investment is often made with the same objectives of those of the private market investor. The Guidelines state that:

“...in general, whether the public funding benefits airports, or is granted directly or indirectly by the public authorities to airlines, the Commission will assess whether it constitutes aid by considering whether ‘in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional-policy and sectoral considerations, would have subscribed the capital in question.’”

The EC also recognises that any profitable airport can apply incentive measures from its own resources. In this way the EC argues that the Guidelines make no differentiation between public and private sector ownership of airports.

A public airport must be able to prove that it acts as a ‘private market investor’, for instance with a business case showing the forecast profitability for the airport from investment in a new route. In essence, if the business case makes sense, State aid rules do not apply. However, the airport remains subject to all other general rules of the Treaty in relation to the incentive measure including transparency, non discrimination and proportionality.

If the market economy investor principle cannot be demonstrated, there is an obligation to notify the EC of the use of public funds. The obligation to notify applies to all airports or public bodies planning to implement publicly funded incentive measures, irrespective of the size of the airport.

5.7 Conditions for Aid to be Compatible

The main concerns relating to start-up aid are that:

- Aid financially benefits air carrier recipients and could impact on competition between carriers.
- Competition between airports can be distorted by helping airports to develop or by encouraging a company to ‘relocate’ from one airport to another and transfer a route from one airport to another.

The EC may approve aid if it fulfils a wide range of conditions.

General conditions

- Air carriers benefiting from the aid must hold a valid operating license issued by a Member State (within the meaning of Regulation 2407/92¹⁸ on licensing of air carriers).
- The aid is related to development of routes between Community airports. This would imply that intercontinental routes (e.g. to the US) and routes outside of the EC are either not covered by the Guidelines or are excluded from receiving start-up aid. This point is ambiguous given the 1999 decision in the Manchester complaint based on start-up aid for a US carrier (Continental Airlines) operating to New York and was used as a reference for the Charleroi decision.
- Aid can only be given to routes departing from Community airports in Category C (1 to 5 million passengers - Shannon) and D (less than 1 million passengers - Knock, Galway, Sligo and Donegal). In certain exceptional cases, aid for routes between Category B airports (five and ten million passengers) can be considered from airports located in outermost or economically disadvantaged regions.
- Aid can only be given for new routes or increased frequency on existing routes that do not compete with existing services, and must have the goal of increasing the net volume of passengers to improve the overall financial viability of the regional airport.
- Aid cannot be granted when a route is already served by high-speed train services. This should not be an issue for the Western Region which does not have such services.
- Aid can only be granted to develop a new route or increased frequency and cannot be used to replace an existing or similar route from the same or another airport serving the same city, conurbation or airport system (e.g. airports in the Paris or London systems).
- The aid must not encourage a transfer of traffic from one carrier to another or from one airport to another. However, the substitution of one route for another route during the aid period leaving from the same airport and expected to generate at least the same number of passengers does not prevent the granting of aid for the remainder of the period, so long as the other initial criteria have been fulfilled.
- The long term financial viability of the route must be demonstrated i.e. it must at least cover its costs without public funding leading to the requirements for aid to be degressive and of limited duration. The aid period must be less than the period undertaken by the carrier to operate the route as part of the route business plan showing route profitability and sustainability over time.
- Aid should be stopped once the objectives in terms of passengers carried or route profitability break even have been achieved, even if either of these has been achieved before the end of the aid period.
- The aid must be limited in duration with a maximum of three years. Aid can be granted for up to 5 years for outermost, sparsely populated or disadvantaged regions. Routes from the Western Region could qualify for aid of up to five years if the EC accepts that the region fulfils the criteria.
- The aid must be degressive i.e. reduce over time. Intensity of the aid cannot exceed 30% of the total allowable start-up costs for a maximum period of 3 years, and a maximum of 50% of the eligible costs over the first year.

¹⁸ OJ Council Regulation of 23rd of July 1992 on licensing of air carriers (OJL 240) of 24 August 1992

- For the nine outermost regions, aid cannot exceed 40% of the total allowable start-up costs for a maximum period of 5 years, and a maximum of 50% of the eligible costs over the first three years.
- Aid per passenger must reduce as passenger numbers increase. In an example of degressive structuring to maximise front end aid, the Year 1 aid could be a maximum of 50% with the remaining 40% (i.e. 3 x 30% per annum) spread over Years 2 and 3. In the event that the route does not operate for the full period, a 'clawback' mechanism will be required to repay the aid.
- Aid must be strictly linked to the allowable additional start-up costs directly incurred in launching a new route or adding frequency to an existing route i.e. exceptional costs rather than ongoing operating costs. Examples of allowable costs include:
- Route specific marketing and advertising costs.
- Capital cost of additional facilities required at the regional airport if these costs have not been financed by other types of aid.

These costs must be 'real' i.e. those normally obtained under normal market conditions.

- Aid cannot be granted for standard operating costs related to the ongoing operation of the aircraft, fuel, catering, crew costs and airport charges. This is a major departure from the previous Manchester and Charleroi decisions where publicly funded reductions in airport charges, which are viewed as normal operating costs, were allowed as part of an overall start-up incentive package for the airlines.

However, airport charges incentives can still be offered by the airport operator from its own resources as long as the operator is profitable and the incentives offered are transparent, non discriminatory, are proportional and have a supporting profitable business case.

For loss making airports receiving operating subsidies, it would be difficult to justify significant airport charges incentives to stimulate traffic without a realistic expectation of breaking even in a relatively short period.

Transparency and non-discrimination

Any available public start-up aid, whether via an airport or not, must be made public and with adequate publicity to alert all airlines of the availability of the aid.

The publicity must include a description of the route and objective criteria to be used in awarding the amount and duration of aid.

Airlines must provide a business plan that shows the route reaching profitability over a 'substantial' period after the aid has expired.

Analysis of impact on existing routes is required before granting aid, as well as including an impact assessment study on existing competing routes (generally viewed as operating from the same airport).

Publicity, appeal and penalties

Publicity - Member States must ensure that details of routes receiving aid are published on an annual basis for each airport. Information required to be published includes:

- Source of public funding.
- Recipient airline.

- Amount of aid paid.
- Number of passengers to whom the aid relates.

Appeals - appeal procedures must be provided at the Member State level to ensure there is no discrimination in the granting of aid.

Penalties - a system for aid recovery must be in place in the event that a carrier fails to maintain any route operating undertakings given in relation to the aid.

Notification Requirements

The Guidelines state that start-up aid must be notified otherwise the aid is illegal and is subject to challenge at any time leading to possible suspension or refund of the aid.

The EC's preference is for Member States to notify start-up schemes rather than individual cases e.g. a scheme covering all of the airports in the Western Region rather than for one or more airports.

Aid must be notified before it is allocated. Aid can only be granted if the EC has taken (or is considered to have taken) a decision authorising it.

Notification must be submitted to DG Mobility and Transport via the Member State using standard State aid notification procedures. The notification documentation will include:

- Total duration of the aid period.
- Total amount of the aid.
- Airports concerned.
- Beneficiaries and selection criteria for granting the aid, the conditions and non performance recovery system.

The EC will acknowledge receipt of the notification and inform the Member State if it is incomplete. A notification is considered complete if the EC has not requested any further or supplementary information within two months following receipt of the notification.

Within two months after receipt of the complete notification, the Commission is required to have conducted a preliminary investigation with 4 outcomes:

- **There is no aid** - the Commission makes a formal decision stating there is no aid.
- **There is aid which is compatible with the market** – the Commission makes a decision to authorise the aid.
- **There is aid which is incompatible with the market** – the Commission makes a decision not to authorise the aid.
- **There is a doubt** – the Commission decides to open a formal procedure of investigation.

If the EC has not taken a decision within the two months deadline, the aid is declared authorised. The Member State then informs the EC of its decision to implement the measure at which point the EC has fifteen working days to respond.

If the EC opens a formal investigation procedure, it must, after a process that is not limited in time, take a final decision:

- There is an absence of aid.
- There is aid which is compatible with the common market.
- There is aid which is incompatible with the common market.
- Approval of the aid subject to conditions.
- Illegality of the aid.

5.8 Date of Application

The Guidelines applied from their date of publication in the Official Journal of the European Union on 9th December 2005. However, the Guidelines state that they set out for information purposes the EC's general interpretation of the issues and are without prejudice to the interpretation of the Courts.

Member States were asked to confirm in writing that they accept the Guidelines by 1st June 2006. The Guidelines required Member States to amend any existing aid schemes covered by the Guidelines to comply by 1st June 2007.

The EC undertook to conduct a detailed assessment of the application of the Guidelines 4 years after the date of application i.e. in 2010. A summary of informal discussions on the likely form and timetable for this review is included in Section 4.

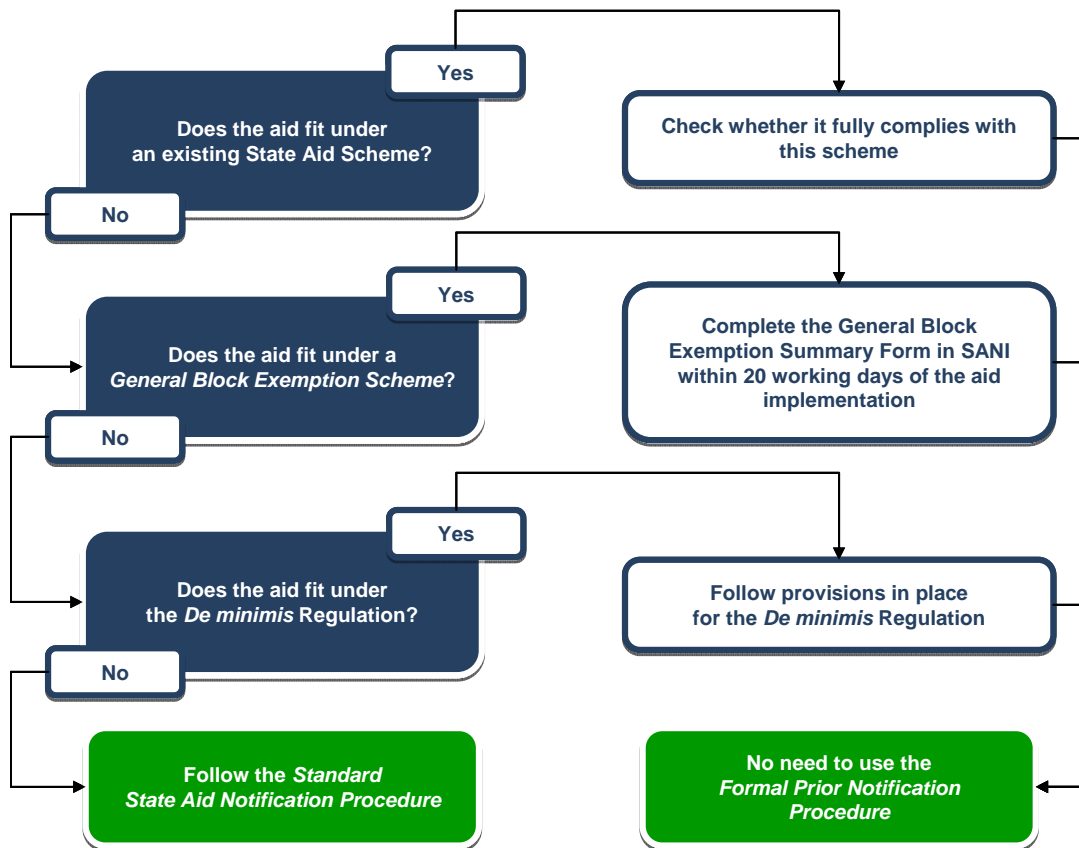
5.9 State Aid Application and Approvals Process

As a general rule, any State aid has to be formally notified to the EC before it is awarded through a "Formal Prior Notification Procedure" with EC approval required before aid is awarded.

As discussed in Section 3, no formal prior notification procedure is necessary in the following cases:

- The aid fits under an existing approved State Aid Scheme.
- The aid fits under an existing General Block Exemption Scheme.
- The aid can be granted as de minimis aid.

Figure 1: State Aid Notification Decision Process



Notification procedure for aid under an approved State aid scheme

As there is no approved scheme in place in Ireland, this is not an option for the Western Region.

Notification Procedure for aid under a General Block Exemption Scheme

As there is no general block exemption for start-up aid to airlines, this would not be an option for the Western Region.

Notification procedure for aid under the de minimis Regulation

Where a scheme fits within the de minimis Regulation, there is no need to use the formal prior notification procedure.

5.9.1 Notification of start-up aid

Since start-up aid in the aviation sector does not fall into the above exemption categories, it would require notification for approval in line with the requirements set out in the EC’s Guidelines.

Since 1st January 2006, many aspects of the communication between the aid awarding body and the Commission take place through the electronic SANI (State Aid Notification Interactive System). The Irish State Aid Section in the Department of Enterprise, Trade and Innovation (DETI) administers the SANI system in Ireland and must be contacted to gain access to the system through:

State Aid Section
 Room 411, Department of Enterprise, Trade and Innovation
 Kildare Street, Dublin 2
 Ph. 01 631 2920 Fax: 01 6312845

Email: StateAidIreland@deti.ie

A user name and password are required to access the SANI system at:

<https://webgate.ec.europa.eu/competition/sani/login/index.cfm>

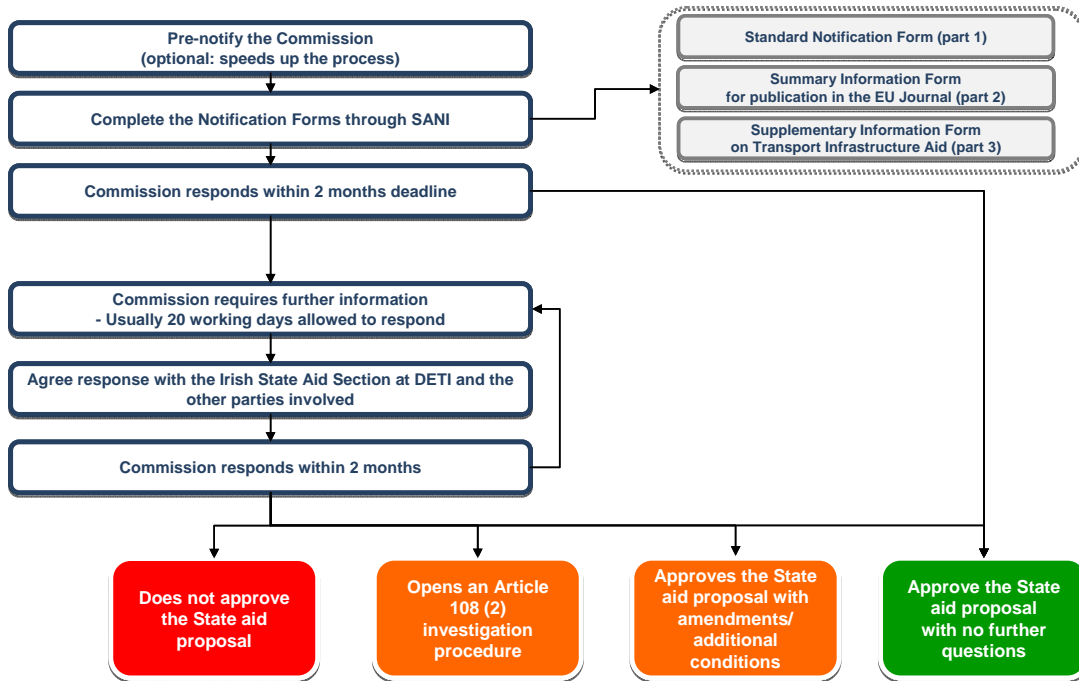
The criteria for compliance are set out in the Guidelines with the electronic notification form structured to ascertain if the proposed scheme meets the requirements.

It is common for informal pre-notification meetings to be held with the EC to discuss the details of the scheme, get informal feedback and ascertain the type of additional information likely to be required to enable the EC to fully review the scheme, thereby avoiding delays in the review process.

The notification form consists of three parts:

- General Information which must be completed for all applications.
- Summary Information for publication in the Official Journal.
- Supplementary Information Sheet.

Figure 2: State Aid Assessment Process



Parts I and II of the notification form must be completed on the SANI electronic notification system. Part III, the Supplementary Information Sheet can be submitted as an attachment to the electronic notification. Electronic notifications are validated by the Irish Permanent Representation in Brussels and formally notified to the EC.

Each Minister/Department will retain the primary and ultimate responsibility for compliance with EU State aid law of any scheme which it (or any body under its aegis) operates. This includes fulfilling the requirements, such as prior notification and annual reporting on schemes.

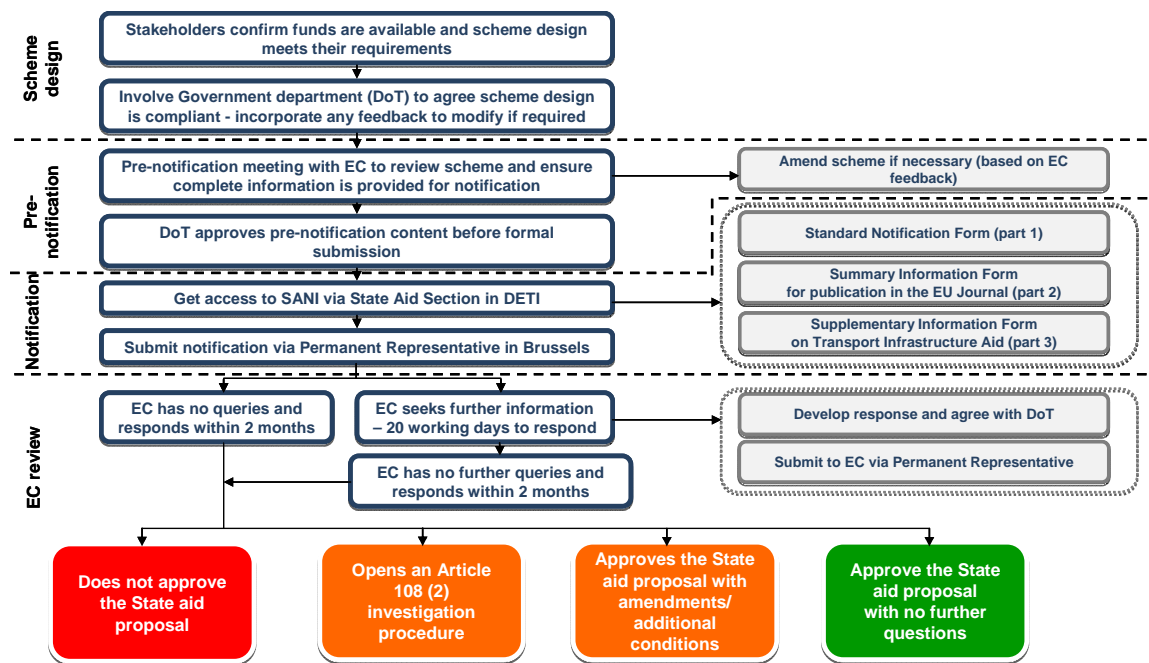
Each relevant Government Department/Office (e.g. Department of Transport) has appointed a designated co-ordinator on State aid who sits on the Inter-Departmental Co-ordinating Committee, chaired by the State Aid Section of DETI.

This body oversees the monitoring, controlling and reporting on payments under existing schemes, and responds to queries on these and other issues from the EC. There is also an on-going programme of work at EU Commission, EU Council and European Parliament level to be serviced with a co-ordinated Irish position.

Application and approvals stages

The following section and figure outline the stages required to get approval for a Guidelines compliant scheme to provide aid for route development from airports in the Western Region.

Figure 3: State Aid Detailed Application and Approvals Process



Scheme Design

Careful design of the proposed scheme is a critical stage to ensure that the characteristics fit within the Guidelines in terms of the objectives sought and the operational aspects comply with the specific requirements set out therein. The specific requirements have been set out earlier in this section.

Early involvement of the providers of funding is advisable to ensure that the funds are available and meet the specific requirements of the contributing stakeholders. Typically financial support has been provided by State funded tourism and economic development bodies. The Scottish and Malta case studies in Section 6 explore this in more detail. Private sector funding for a Guidelines compliant scheme is less common as this would tend to follow a market economy investor route which would not fall into the State aid remit. The Swedish case study included in Section 6 illustrates how this works in practice.

It would also be advisable to involve the 'sponsor' Government department which would eventually be the entity submitting the scheme to the EC for approval. For aviation related matters in Ireland, this would be the Department of Transport (DoT).

The design of a compliant scheme should be relatively straightforward as the Guidelines provide specific guidance on requirements and a number of decisions relating to approved schemes are available to act as a guide.

Pre-notification

Following agreement between the stakeholders and DoT that the proposed scheme is compliant, the opportunity to discuss the scheme with the EC in advance of a formal notification submission should be considered.

Whilst this is optional, it is welcomed by the EC to give them advance notice of the notification and to get their informal feedback that may lead to amendments to the scheme prior to submission. This stage is also useful to ensure that all of the required information is provided as part of the initial submission to avoid requests for further information which delays the overall review process timescales.

The pre-notification can be via an informal meeting and/or submission of a draft notification outside of the SANI electronic notification system.

It would be expected that the DoT as the (likely) sponsor department would approve any pre-notification materials before submission as well as involving the State Aid Section at DETI and the Permanent Representative in Brussels for their input.

For a meeting with the EC, it would be expected that the DoT and the Permanent Representative would also be involved along with the scheme proposers.

Notification

For notification, the procedure is self-explanatory with the electronic forms taking the applicant through a series of questions to ascertain the need for aid, the type of aid and how it complies with the appropriate Guideline.

Involvement of DoT for the sector specific aspects of the notification, possibly the State Aid Section at DETI for wider State aid related issues, and the Permanent Representative would be useful to ensure the application process is followed correctly to reduce the risk of additional information requests which would extend the review period.

The scheme proposers would be required to:

- Get access to the SANI via the State Aid Section at DETI.
- Complete the Standard Notification Form ("*Part 1*").
- Complete the Summary Information for publication of the State aid proposal in the EU Official Journal ("*Part 2*").
- Complete the Supplementary Information Form ("*Part 3*") in word document format (downloadable from SANI).
- Upload the Supplementary Information Form onto the appropriate section of SANI

EC review process and timescales

The electronic notifications are submitted by the Permanent Representative in Brussels. The EC has a maximum period of two months to respond to the submission.

Where a carefully designed scheme has been discussed with the EC in advance of the formal submission and any concerns addressed in the formal notification, in most cases the EC will approve the aid with no further comments.

If the EC requires further information, the Member State (via DoT) has 20 working days to respond. If no response is received within this period, the notification is assumed to have been withdrawn

Where additional information has been requested, the scheme proposers would have to agree the response with DoT, and possibly the State Aid Section at DETI, before onward transmission to the EC through the Permanent Representative.

There is no limit on the number of requests for additional information. However it would be unusual for the EC to issue multiple requests.

On receipt of all information, the EC must respond within 2 months otherwise the scheme is deemed to be compliant. In its decision, the EC could:

- Approve the State aid proposal with no further questions.
- Approve the State aid proposal with amendments / additional conditions.
- Not approve the State aid proposal.
- Decide that more detailed scrutiny on the State aid proposal is necessary and open an Article 108(2) Investigation procedure.

Article 108(2) investigation procedure

If the EC has doubts about the compatibility of the aid measure with the common market, it will initiate Article 88(2) proceedings, known as a 'formal investigation' as they did for the Charleroi complaint.

It publishes a description of the aid in the Official Journal and on its website and would invite Ireland and interested parties to comment. The development of any response would again involve the scheme proposers, the DoT as the (likely) sponsor department, the State Aid Section at DETI and the Permanent Representative in Brussels for their input.

At the end of the enquiry, the Commission adopts a final decision. This may be either:

- Positive (aid can be implemented).
- Negative (aid cannot be implemented).
- Positive, subject to stated conditions (aid can be implemented if certain conditions are met).

The indicative maximum time-limit foreseen for such an enquiry is 18 months.

6 Case Studies

6.1 Introduction

This section reviews case studies of a start-up aid approval in compliance with the Guidelines as well as a market economy investor measure, and the steps undertaken by the various stakeholders from initial consideration of the scheme to granting of EC approval. A pre-Guidelines case study of a successful route development scheme is also included.

Detailed case studies of three different types of public sector intervention to encourage airline route development include:

- **Pre Guidelines intervention** - Scottish Route Development Fund.
- **Guidelines compliant intervention** – Malta Air Route Development Scheme.
- **Market economy investor intervention** – Norrköping (Sweden) Air Route Risk Share Mechanism.

The case studies include a description of the scheme and its design process through to its implementation and 'post aid' route performance. The success of these schemes is discussed from a regional airport and route development perspective.

6.2 European Market Background

In the last five to ten years, the European aviation market has experienced a number of increases and decreases linked to macro events with a slowdown in the early years of the decade post the terrorist attacks in the US in September 2001.

The slowdown in aviation demand at the back end of 2001 and into 2002 was followed by strong recovery growth in 2003 and 2004. There was further but lower growth through to 2007 with a marked slowdown in 2008 followed by significant contraction in 2009 reflecting the full year impact of the worldwide economic recession.

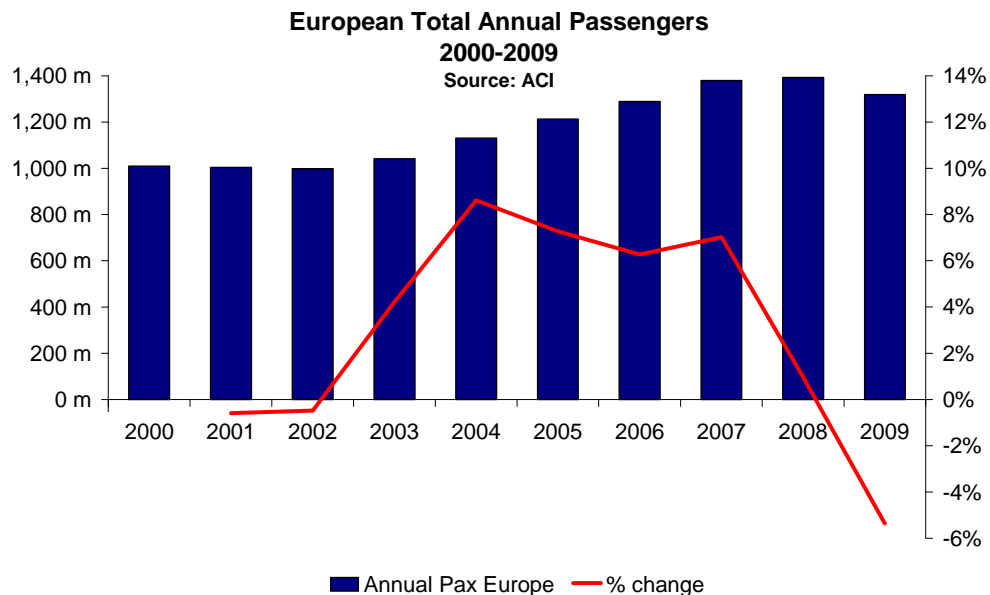


Figure 4: European Traffic Growth, 2000 to 2009

To date, 2010 has been a recovery year with total European passenger traffic in January to October increasing by +4.7% compared with the corresponding period in 2009, but was still a decrease of -3.9% when compared with the same period in 2008.

6.3 Pre-Guidelines Intervention – Scottish Route Development Fund

The Scottish Route Development Fund (the “Fund”) was established in 2002 with the objective to improve business connectivity and inbound tourism by sharing the start-up financial risks of providing air access on a year round basis with airlines and airport operators.

Scotland has around eighteen airports of varying sizes. Highlands and Islands Airports operates eleven smaller regional airports supported by annual operating and investment funding provided by the Scottish Government. The larger airports are financially self-reliant.

An aim of the intervention was to ensure that routes from the smaller airports were supported on the basis that they could be financially sustainable when the support ceased.

EC notification

The Fund was not notified to the EC. However a number of discussions were held with the State aid unit of DG TREN to explain the Fund's objectives, the market failure sought to be corrected through the intervention and the detailed structure of the mechanism. The principles of transparency, proportionality, limited duration and non-discrimination were built into the funding criteria.

Clear route eligibility criteria were included to ensure investment was targeted at those routes providing maximum economic benefit for Scotland. As an example, routes proposed to operate from the larger Scottish airports at an average of less than 3 frequencies per week on a year round basis were excluded as were routes to outbound leisure destinations (e.g. Canary Islands, Spanish coastal resorts). Reduced frequency requirements were applied to routes from the smaller regional airports.

Detailed route and economic appraisal of the likely benefits of each applicable route was carried out to determine the likely benefit and cost benefit contribution to the Scottish economy to support the case for investment. Primary drivers of the economic assessment were benefits including whole journey time savings (with a value placed on time saved travelling on direct routes), air fare savings, direct jobs created and additional tourism spend netted against the cost of investing in the route.

Form of aid

Aid took the form of reducing aeronautical charges levied on airlines by airports for qualifying routes, typically for periods up to three years, by providing a level of investment paid to airports on a per passenger carried basis. The airport then bundled this funding with their own incentives including further aeronautical charges discounts and marketing contributions to promote the route.

Payments by the Fund to the airports were made in arrears on a per passenger basis, i.e. after the economic benefit had been delivered. A limit of funding up to 75% load factor ensured that the level of investment was proportionate. Separately, tourism bodies worked with the airports and carriers on marketing the routes through co-operative marketing programmes.

Fund participants and management structure

The public participants comprised a partnership between the Scottish Government, Scottish Enterprise (main economic development agency), Highlands and Islands Enterprise (regional economic development agency) and Visit Scotland (main tourism body).

The Fund was managed on a day to day basis by Scottish Enterprise resources with responsibility for negotiating with airlines and airports on eligible routes, duration and intensity of support. Overall direction and governance was provided by a Board comprising Scottish Enterprise, Scottish Government and VisitScotland.

Level of investment

The Fund was initially set at £6.8m and later increased to around £10m.

Timescales

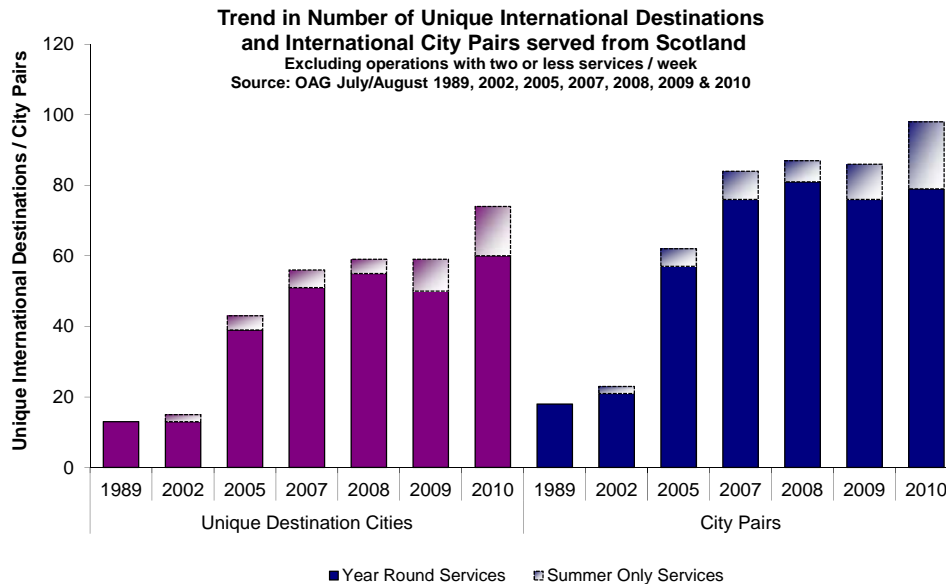
The Fund was launched in November 2002. The first new routes supported began operation in spring 2003. The last supported routes commenced in summer 2006 with final payments in summer 2009.

Impact

Prior to the introduction of the Fund, benchmarking of Scotland's international connectivity demonstrated that it compared poorly to similar regions and countries. On the basis of this historic data analysis, it was accepted that, in the absence of the Fund, the Scottish international route network would not have experienced significant growth.

However, the number of unique international destinations served from Scotland (destinations served from more than one Scottish airport are only counted once) grew from 13 in 2002 to 74 in 2010.

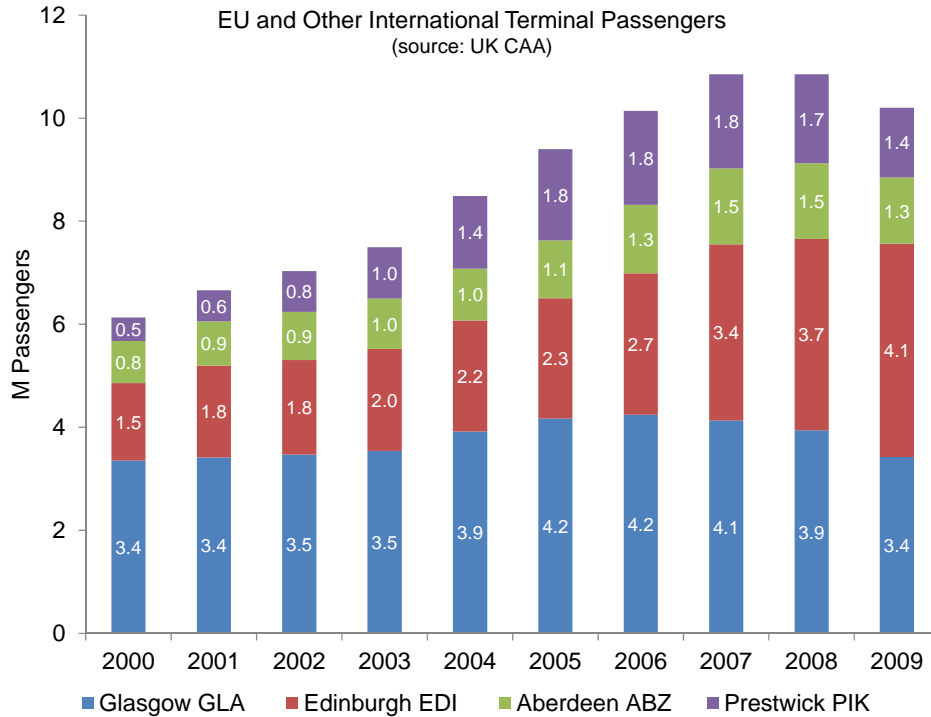
The total number of international city pairs served (all international services from Scottish airports are included) grew from 21 in 2002 to 98 in 2010. The majority of new routes and services received some form of Fund investment. Growth in 2008 was limited followed by flat performance in 2009 due to the recession impact. Continued growth was experienced in 2010 in both unique destinations and city pairs served as the wider European air passenger market started to recover.



Total international passengers at Edinburgh, Glasgow, Aberdeen and Glasgow Prestwick (Scotland's main airports) grew from 7m in 2002 to 10.2m in 2009 (45% increase).

Routes were also supported at the smaller regional airports of Inverness and Dundee.

Edinburgh recorded the highest increase in international passengers in the 2002 to 2009 period increasing from 1.8m to 4.1m (+125%).



One of the features of the Fund was the ability to invest in routes served by a wide range of carriers from all market segments including low cost (Ryanair, Easyjet, Germanwings, Wizz), full service short haul (SAS, BMI), full service long haul (Emirates, Continental, Delta) and regional carriers (Eastern Airways, Aer Arann, BMI Regional).

The Fund ceased in its current form at the end of May 2007 on the basis that the identified market failure had largely been addressed. Routes that received offers of support by that date remained eligible for funding for the duration of the offer period providing the conditions of investment were maintained.

A total of over 50 routes received some form of investment during the life of the Fund with total investment of circa £9m. In January 2010, a total of 31 year round routes that received Fund investment continued to operate.

For the smaller regional airports, the Fund supported a number of new routes including Inverness to Dublin (Aer Arann), Bristol (Easyjet) and Birmingham (Eastern Airways). The Bristol and Birmingham routes continue to operate.

At Dundee, new routes to Birmingham and Belfast (both Loganair/Flybe) were supported and continue to operate.

It is always difficult to isolate factors in an overall growing aviation market. However, the historic benchmarking would tend to indicate that the level of improvement in the Scottish route network would not have been achieved without public sector intervention to encourage the establishment of new routes.

6.4 Guidelines Compliant Intervention - Malta Air Route Development Scheme

Malta's Air Route Development Scheme (the "Scheme") commenced in 2007 with the objective to facilitate development through access to air transport services which are of basic importance for the economic and social development of Malta.

Malta has only one airport and is heavily dependent on inbound tourist traffic, particularly in the summer season. There is a significant reduction in connectivity during the winter season.

The Maltese authorities believe that the Scheme will contribute to regional development by:

- Encouraging the development of new air links and therefore connectivity to the rest of Europe.
- Improving accessibility and competitiveness for Malta's businesses by developing close links with international markets and through travel time savings.
- Opening up new markets for Malta's businesses.
- Encouraging inward investment.
- Encouraging inbound tourism.

The Scheme sought to improve business connectivity and inbound tourism by sharing the start-up financial risks of providing air access on a year round basis with airlines and airport operators.

EC notification

The Scheme was notified to the EC on 25th September 2006 and received approval on 22nd November 2006, within the two month limit. The Scheme became operational immediately.

Based on the EC's decision, the notification clearly outlined the rationale, objectives, market failure sought to be corrected through the intervention and the detailed structure of the mechanism. The Scheme structure mirrored the criteria set out in the EC's Guidelines and as such, the EC deemed that the Guidelines conditions had been satisfied.

Form of aid

Aid will only be granted in respect of eligible start-up costs and costs for specific route marketing. Operating costs such as airport charges, aircraft rental fuel, etc. are not eligible. Funding will be provided for a maximum period of five years.

The Government of Malta will periodically issue calls for the development of new routes with sufficient publicity specifying:

- The routes to be developed.
- What qualifies as a new route.
- Details of the Scheme, specifying the aid intensity and duration.
- Which airlines are eligible to apply.
- The documentation and information required from the applicants.
- The selection criteria.
- The way in which the ranking of the offers and the awarding of the route(s) will be made.

- Where the offers are to be submitted and the closing date of the call.
- Financing modalities and penalties.
- Where prospective applicants are to obtain further information about the call.
- The legal basis.

Submissions are evaluated on the basis of a number of selection criteria included in each of the calls issued and a contract signed between the airline and the Government of Malta.

The criteria to determine an economically advantageous offer for each route are:

- Technical value: quality and suitability of technical, commercial, marketing, sales and human resources made available for the development of the route(s), expected results: (40%).
- Financial value: amount of the financing requested per passenger (40%).
- Date of route start-up: (20%).

A route business plan is required to demonstrate that the route will be profitable within a reasonable period. For the marketing contributions, a route development plan covering a period of five years is required in advance for each route. The plan must highlight the costs directly related to the promotion of the route with a maximum of 50% of eligible costs receiving support in the first three years with up to 25% being available in the final two years of support. Malta is not defined as an outermost region but successfully argued that it was a sparsely populated island requiring longer duration support for air services which enable integration with the rest of the EU. In addition, better cohesion with other Member States will lead to social and economic benefits for Malta's citizens.

The contract will stipulate the amount of financing to be granted per departing passenger and the plan to be implemented by the air carrier, including the number of guaranteed passengers. The contract may be terminated by either party with twelve months notice.

Payments to the airlines are made in arrears at the end of the operating season (after March for the winter season and after October for the summer season). The carrier is required to submit proof of the start-up costs incurred and that the contracted passenger volumes have been realised. Payment will be pro rata to the achieved passenger numbers except that no payment will be made if less than 50% of the stipulated volumes of passengers were carried.

Scheme participants and management structure

Specific details are not available as to how the Scheme works in practice. Based on press releases by carriers, the Scheme is operational and seems to be coordinated through the Office of the Prime Minister and administered by the Malta Tourism Authority.

We assume that Tourism Authority resources negotiate the specific marketing campaigns with the respective airlines and monitor performance against the five year plans in line with the EC approval.

Level of Investment

The total budget for the Scheme is significant at €58.2m (annual: €11.6m).

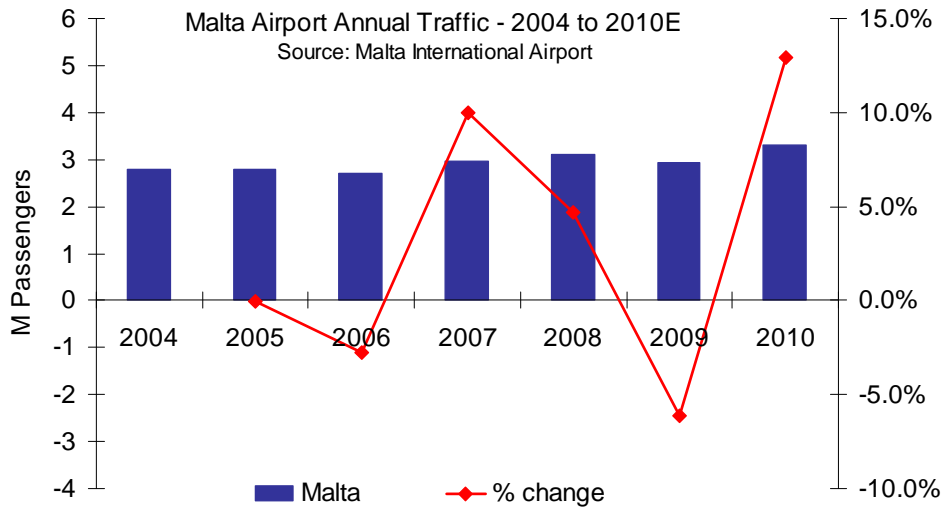
Timescales

The Scheme is planned to last from September 2006 to September 2011.

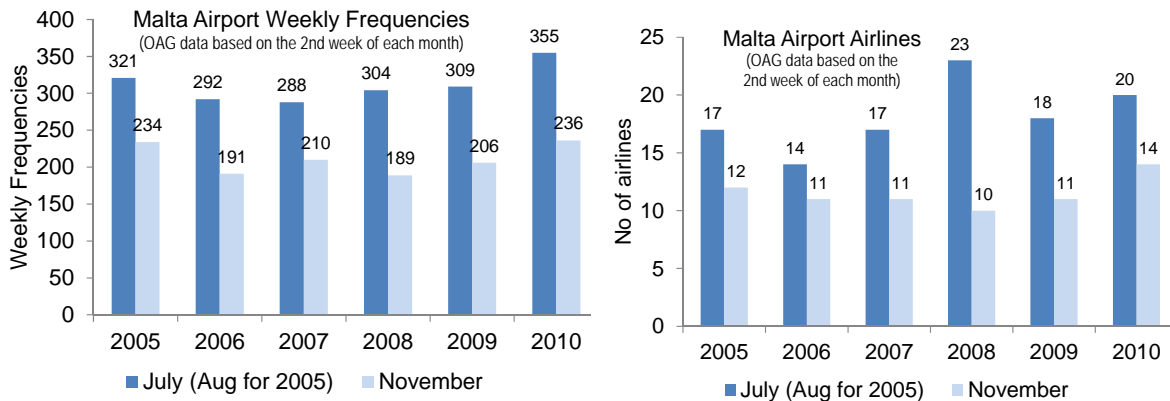
Impact

The period 2004 to 2010 provides an indication of traffic performance both before and after introduction of the Scheme.

Annual traffic has grown from circa 2.7m in both 2004 and 2005 to 3.1m passengers in 2008 as a result of strong growth in both 2007 and 2008 following introduction of the Scheme. Traffic declined to 2.9m in 2009 when the economic downturn across Europe was at its peak. Strong growth in 2010 should bring traffic to circa 3.3m.



Summer destinations grew from 54 to 66 and winter destinations from 38 to 50 in the period.



The number of airlines serving Malta also increased in the period from 14 to 20 in the summer and from 11 to 14 in winter. Another key measure, the number of weekly frequencies has also increased from 292 (2006) to 355 (2010) in the summer and from 191 (2006) to 236 (2010) in winter.

Service has increased on several routes including Stockholm, Madrid and Barcelona and new routes have been opened including Bari, Bremen and Leeds/Bradford. A number of new airlines started to serve Malta following the launch of the Scheme included BMIbaby, Clickair, Easyjet, Iberia, Jet2, Norwegian Air Shuttle, Ryanair, Smartwings, Spanair and Vueling.

As with Scotland, the worldwide recession makes it difficult to isolate factors in an overall growing aviation market. However, the significant growth in the Malta annual traffic after 2006 when the Scheme was launched would tend to indicate a positive stimulatory impact.

6.5 Market Economy Investor - Norrköping (Sweden) Air Route Risk Share Mechanism

Norrköping airport (the "Airport") is located approximately 165 km from Stockholm. Norrköping Municipality owns and operates the Airport. In 2001, around 130,000 passengers travelled on the only main scheduled service from the Airport to Copenhagen (and onwards). Following the withdrawal of SAS that year, by 2005 only around 30,000 passengers used the Copenhagen route.

The Municipality and local industry identified the need for good air services for Norrköping to the rest of Europe as the competitiveness of local industry and its ongoing development depend on good access connections from the region.

EC notification

The Swedish authorities submitted details of a measure they did not consider to be State aid to the EC for reasons of legal certainty. The measure was notified to the EC on 24th November 2006 and additional information requested by the EC on 22nd December 2006 and 26th April 2007. The Swedish authorities provided additional clarification on 23rd February 2007 and 15th May 2007.

The measure was considered not to be State aid in the EC's decision dated 10th July 2007. The decision took around seven months due to the EC's requests for additional information extending the process. Following confirmation from the EC that the mechanism was not State aid, it became operational immediately.

Form of aid

The measure concerned the formation of a marketing company, Marknadsföringsbolaget Nya Norrköping AB ("Nya Norrköping") to enter into agreements with airlines to operate new routes to serve the Airport.

The marketing company invited the Municipality (as the Airport owner), its private-sector owners and a number of external private companies (i.e. companies who are not shareholders) to participate in a "risk and development fund" (the "Fund") to be administered by Nya Norrköping (the Airport's website lists 25 private sector companies as participants in the Fund in 2010).

The Fund enters into risk sharing agreements with airlines to provide temporary financial guarantees to add new destinations and/or frequencies with the Fund participating in profits generated.

The objectives of the Fund are to offer:

- A relatively low-risk financial gain for investors.
- Improved flight connections.

Nya Norrköping's aim is to work with local industry investors to develop the Airport. Studies show that around 75% of passengers from the area use other airports, particularly Stockholm Arlanda.

The Airport had only one regular operator with lower capacity than other airports, especially at peak times. The carrier had also stated that it planned to cease operations leading to the risk that the airport would close. The Municipality and local industry were of the opinion that this would have a very negative impact on competitiveness and choice for industry in the region.

During 2006, the marketing company made contact with a number of airlines to ascertain the possibilities of, and requirements for developing air services from the Airport.

Following an economic benefits assessment, the Municipality assessed that the measure would result in economic advantages. Whilst specific details of the economic assessment are not available, it is likely to have examined journey time and airfare savings along with any employment and tourism spend benefits netted against investment costs. The market research indicated demand for services which would result in increased passenger numbers, and passengers being offered a better product.

Forecasts indicated that it would be possible to regain 50-60% of 2001 levels in the initial phase, i.e. 65-70,000 passengers per year on the Copenhagen service. In a second phase offering additional destinations, it should be possible to attract 100 -130,000 passengers per year.

The intention is that a number of operators would enter into contract with Nya Norrköping to share the commercial risk associated with starting new routes or adding frequency on existing routes. The contracts would be for 12 to 36 months on the basis of guaranteeing the operator a net financial result on a particular route. If the operation is not profitable, Nya Norrköping would compensate the operator up to the agreed net result.

The partners meet every 3 months to calculate the operating result of the route and make a payment if the result is negative. In the event that the operation is positive, any amount in excess of the net result would be proportionately shared between Nya Norrköping and the operator. However, positive performance would not result in a distribution until a cumulative result had been reached over a longer period (to be agreed on a route by route basis). This deferral of payment to the investors reflects the higher level of risk exposure carried by the airline in starting a new route as well as the seasonal nature of income typical in the airline business.

The operator has the risk and costs for investment in capacity, staff, marketing, distribution, etc.

The operator agrees to share future profits in exchange for the Fund providing working capital during the start-up phase. Once the contract has finished, the airline has complete control over the route.

All routes must be forecast to be profitable within 12-36 months. A break-even number of passengers per year would be agreed with the airline based on an agreed revenue and cost model.

The measure is based on shared risk with the main risk that the expected passenger volume is not achieved within the duration of the project.

The risk for the airline is that aircraft capacity would have to be redeployed in the event that the route was not successful. Operators would also be responsible for any redundancy or relocation costs.

The target was to set up services to specific destinations within a defined period. The first target destination was to a European hub with a specified number of daily frequencies.

In the opinion of the Swedish public authorities the measure is not State aid as the public authorities act as a private investor. That the measure is not State aid is evidenced by the following:

- The measure is an investment made with the purpose that it is economically advantageous for the Municipality and that there are solid grounds for assuming that this will be the case.
- Private companies will make corresponding investment on the same terms as public authorities.

The EC decided that the notified measure was not State aid due to:

- Public authority investment in the Fund is proportional to its share in the marketing company.
- The decision to establish the Fund was jointly taken by the Municipality and private industry.
- Private investors investing in the Fund on the same terms and timescale as the Municipality.
- Municipality cannot invest by itself if private investors decline to invest in a route proposition.
- The airlines having significant risk exposure to the route.

- The principle of concomitance of contributions is satisfied i.e. all investors are contributing in the same manner, at the same time and on a proportional basis with the public sector contributions not exceeding 50% of total investment.

Scheme participants and management structure

Norrköping Municipality owns directly and indirectly 50% of Nya Norrköping, while the other 50% is owned by 7 private companies. The marketing company also invited a number of external private companies to participate in specific route investments.

The Fund is administered by Nya Norrköping who assess route performance every three months. All costs and revenues are reported with complete transparency from the airline on each supported route. The information is confidential and not accessible to other airlines. Depending on route performance, payments are made every three months to the agreed level or revenues received following a longer period of positive performance to reflect the route specific financial risks.

Nya Norrköping as administrator of the Fund is required to act on the basis of market assessments in its dealings with air operators. The public authorities have confirmed that the expected return from the measure will be reinvested in the activities of Nya Norrköping.

Level of investment

The Municipality would invest a maximum of circa €320,000 or 50% of the total Fund of circa €640,000 with seven private companies declaring their interest in investing in the Fund. Based on a definite amount in the EC decision, it is assumed that financial exposure on any route would be capped at an agreed level.

In the event that a route sustains prolonged losses, the contract can be terminated. However the airline will have to place the capacity elsewhere and is also responsible for any costs related to closure of the route.

Whilst the availability of investment is available to all carriers, the reality is that only one carrier is likely to be financially feasible on a route given the relatively small market size.

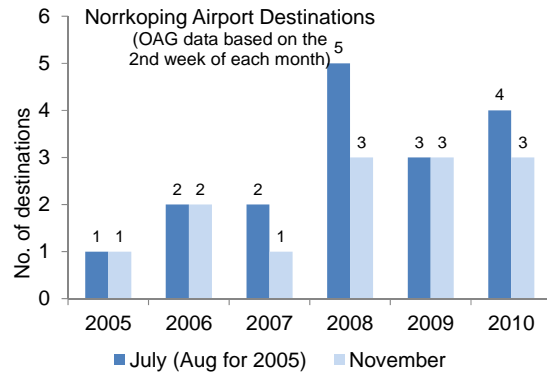
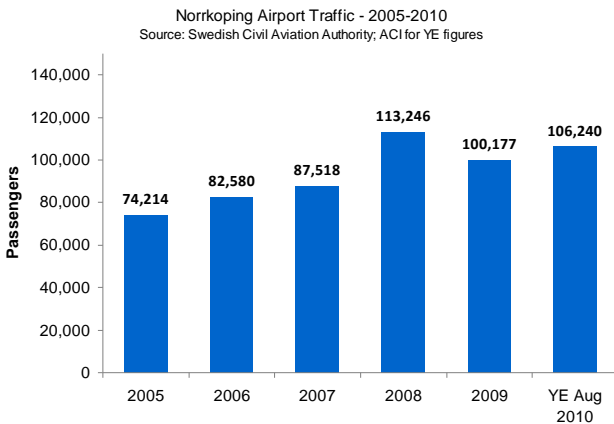
In addition, the airline operating the main route to Copenhagen has already received funding and would be unlikely to continue to receive funding at expiry of the contract unless there was a material change in the service offered on the route e.g. new frequencies, larger aircraft etc.

Timescales

There is no defined timescale for operation of the Fund.

Impact

The period 2006 to 2010 provides an indication of traffic performance both before and after introduction of the Fund. Whilst the Copenhagen service did not appear to stop, the number of passengers using the airport in 2006 and 2007 was relatively flat.

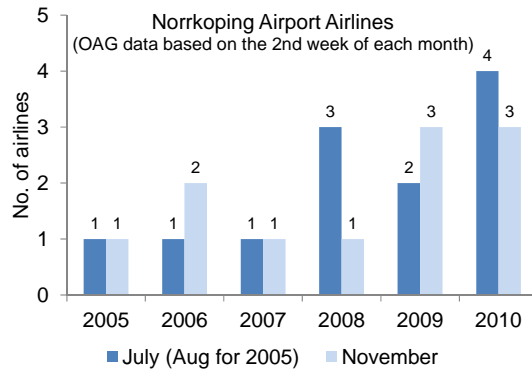
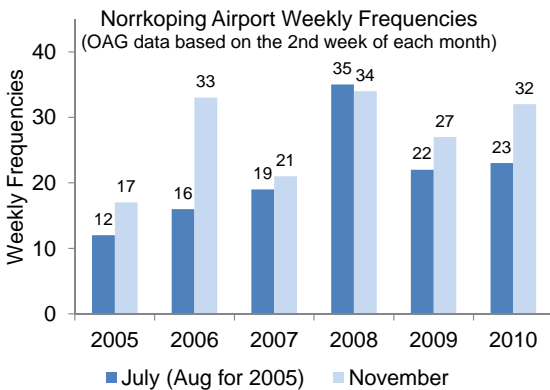


Following implementation of the Fund in July 2007, annual volumes at the Airport have increased from circa 88,000 in 2007 to over 113,000 per annum in 2008. As with the wider European market, 2009 saw a reduction in traffic but the 12 months to the end of August 2010 (latest data) demonstrates some growth.

Scheduled destinations served from the Airport increased from 2 in 2006 to 4 by July 2010 (Helsinki, Alicante, Visby and Copenhagen). Munich was also served in 2008 but this route has now stopped. We understand that all new routes benefitted from Fund investment.

The number of airlines grew from 1 in July 2006 to 4 in July 2010 (Finncomm, DirektFlyg, Cimber Sterling and Ryanair).

The summer weekly frequencies also grew from 16 in 2006 to 23 in 2010, whereas winter frequencies were almost unchanged.



The relatively small market size and impact of the worldwide recession makes it difficult to isolate factors in an overall growing aviation market. There has been definite growth since the initiative was launched in 2007 with the overall impact likely to be clearer when the effects of the recession have receded and a more normalized aviation demand profile returns.

7 Co-operative Marketing Approach

7.1 Introduction

This section provides an overview of a co-operative tourism marketing approach based on the market economy investor principle. The main driver for this type of investment is the efficiency of public and private sector working together to promote a region leading to increase inbound tourism spend to grow the local economy and support existing and future jobs in tourism and support industries.

7.2 Co-operative Marketing Approach

Tourism bodies across Europe have long standing programmes of co-operative marketing with a range of public and private sector partners to jointly invest in promoting regions to target inbound business and leisure tourism markets.

Whilst Directorate-General Transport and Mobility regulates the transport industry including the air transport sector, tourism policy falls within the remit of Directorate-General Enterprise and Industry.

The EU has no “competence” over tourism¹⁹ policy within EU Member States, but plays an increasingly active co-ordinating role in the tourism sector through a number of policies and initiatives.

This would suggest that there should be flexibility in the way that public and private sector parties can co-operate to promote the Western Region in key markets. Carefully structured co-investment in marketing activities by public and private parties provides the opportunity to follow the market economy investor principle thereby mitigating the risk of State aid related issues.

7.3 Background and State aid Considerations

Co-operative marketing approaches are very common across Europe where tourism bodies work with a range of private sector companies with the common aim to market a country or region in domestic and/or international markets.

DG Enterprise and Industry is becoming increasingly active in this area, recognising the economic contribution and job creation opportunities from tourism related activities.

As such, a tourism co-operative investment initiative would seek to position tourism related investment firmly within the EC’s tourism policy area rather than in the more developed transport policy area. It should be noted that the criteria relating to State aid will always apply.

However, the normal promotional activities of publicly funded regional and national tourism bodies frequently mean that they work in partnership with a range of private sector partners on cooperative marketing campaigns. Ensuring that the structure of co-operative marketing follows the same principles of normal marketing co-operative arrangements should help to mitigate, but never eliminate State aid risk.

7.4 Objectives of the Co-operative Marketing

The objectives of a co-investment approach must clearly relate to the tourism sector. There may be other wider economic and supply chain benefits from increased tourism activity; however the objectives must clearly relate to tourism to avoid confusion on the need for investment and which areas of EU policy apply.

The primary objectives of tourism co-operative marketing investment tend to:

- Encourage inbound tourism (encouragement of outbound tourism is explicitly not an objective).

¹⁹ http://ec.europa.eu/enterprise/sectors/tourism/cooperation/index_en.htm

- Improve accessibility and competitiveness for the tourism sector by developing close links with partners to jointly market the country / region in identified markets.
- Encourage, improve or potentially safeguard access from key tourism markets.

7.5 Key Principles

The key principles of co-operative marketing are to:

- Increase visitor numbers from key markets.
- Increase tourism related revenue.
- Work with public and private sector entities to maximise the impact of marketing spend to encourage inbound flows from existing markets and new domestic and/or international markets.

Co-operative marketing must demonstrate:

- Compliance with EU State aid principles.
- Investment represents good value for money.
- Investment decisions are taken on a rational and consistent basis.

To do this, it is important to assess the potential benefits of investment in a particular market. Any investment should fulfil the following criteria:

- Is co-operative marketing aimed at a region/country being targeted for growth? The assessment is generally undertaken by the main public sponsor of the initiative.
- Will the investment lead to a reasonable expectation of a net increase in visitor numbers?
- Is the investment being made by the public sector proportionate to investment being made by private sector partners?
- Does the investment deliver a positive rate of return (this can be demonstrated by simple analysis to calculate the net present value).
- Is the investment mechanism transparent and easily “auditable”? i.e. is it clear how the investment is made and benefits measured? E.g. data to support additional visitors/spend/nights from an inbound area targeted for co-operative investment.

7.6 Mechanism

Co-operative marketing mechanisms seek to establish and structure relationships between public and private sector entities with the aim of investing in the promotion in key inbound tourism markets that meet the investment appraisal criteria.

Investment by the public sector in marketing campaigns is generally in arrears, i.e. after the campaign has been agreed and launched. Depending on the campaign, investment can also be linked to a measurement of benefits e.g. number of additional visitors from a target market.

Private sector investment entities could include airports, ports, airlines, ferry companies, hotel groups or others with an economic interest in promoting increased tourism activity.

Any investment provided should be on the basis of an agreed marketing campaign in the target market with agreed allocation of financial and/or other contributions to the campaign by the respective market partners.

The details and nature of partner investment would be determined on a case by case basis but could include both financial and "benefit in kind" investment such as:

- Access to partner customer databases.
- Access to partner publications including magazines, newsletters and e-zines.
- Access to partner websites and other media for the placement of advertisements, promotions, offers and other information relating to key tourism messages e.g. advertising sites, bill boards, websites etc.
- Access to partner negotiated media purchasing in target markets to avail of better rates.

A market rate for benefit in kind contributions would have to be clearly demonstrated.

The mechanism would be a time limited intervention for domestic and/or international markets that have the characteristics to add to the number of inbound tourists to the country/region.

The amount of funding allocated would be determined between the stakeholders and will depend on the market opportunities, objectives being sought and the likely timescales for investment.

7.7 Technical Characteristics

Core features

Co-operative marketing approaches should have a number of core features:

- Transparency.
- Duration and financial contribution.
- Investment scope.
- Economic criteria.

Transparency

- Details of the co-operative investment opportunities should be made available to all potential partners.
- Investment should be made on the basis of an agreed and costed marketing campaign.
- Investment would be on an open book basis with a requirement for partners to produce details of any expenditure incurred.
- Regular reviews of investment, tourism numbers and expenditure data should be a key feature of the relationship.
- All partner expenditure must be demonstrated as being reasonable and market based.
- Information provided by partners would be treated at all times as commercial in confidence and will not be shared without prior approval.
- Appeal procedures should be available to ensure no discrimination occurs.

Duration and financial contribution

The duration of investment should reflect the size of the potential inbound tourist market, and the forecast time required to establish and maintain brand presence in the market. A maximum period of three to five years for joint marketing activities is likely to be considered reasonable and can be reviewed on an on-going basis.

The financial contribution will depend on the agreed marketing campaign. Investment in campaigns in qualifying target markets would be made on the principle of all costs being demonstrable and verifiable at comparable market rates.

Investment scope

Investment would be related to an assessment of the economic benefits arising from additional inbound tourists. The number of potential inbound visitors should meet minimum thresholds to qualify for investment.

Investment would only be made for an agreed marketing campaign that meets the agreed criteria.

Economic criteria

- Marketing in new or existing markets must demonstrate, via an appropriate economic appraisal, a net economic benefit.
- The market must have a demonstrable inbound tourist demand profile.
- Preference should be given to markets with a clear and sizeable inbound tourist opportunity.

8 Conclusions

- The EC has progressively reduced the flexibility for public sector financial support for air route development as a reaction to perceived market distortions.
- The 2004 Charleroi decision and 2005 EC Guidelines have effectively curtailed the type and levels of public sector support available to support air route development.
- The 2008 Court of First Instance judgement overturning the EC's Charleroi decision due to a failure to correctly apply the market economy investor principle is unlikely to directly impact on any future revision to the Guidelines.
- We understand that the forthcoming review of the Guidelines in 2011 is unlikely to significantly ease the restrictions on the potential operation of compliant route development funds providing start-up aid to airlines at regional airports.
- The process for developing a compliant scheme is straightforward with the EC's Guidelines setting out the detailed criteria required to gain approval.
- However, the relatively small number of notifications for compliant schemes illustrates the success of the Guidelines in restricting rather than encouraging development of new air services from regional airports.
- Whilst Directorate-General Transport and Mobility regulates the transport industry including the air transport sector, tourism policy falls within the remit of Directorate-General Enterprise and Industry.
- The EU has no "competence" over tourism policy within EU Member States, but plays an increasingly active co-ordinating role in the tourism sector through a number of policies and initiatives.
- Tourism bodies across Europe have long standing programmes of co-operative marketing with a range of public and private sector partners to jointly invest in promoting regions to target inbound business and leisure tourism markets.
- Development of a properly structured and administered tourism co-operative marketing approach would appear to offer more scope for innovative partnerships between private and public sector parties with the joint aim of promoting the Western Region in key inbound tourism markets.