FLORENCE SCHOOL OF REGULATION

ROBERT SCHUMAN CENTRE

POLICY BRIEF

EUROPEAN TRANSPORT REGULATION OBSERVER

Short- and Mid-Term COVID-19 Effects on the Aviation Sector: A Competition Law Perspective

Highlights

On 19th March 2020, the European Commission adopted a Temporary Framework for State Aid measures, which is based on Article 107(3)(b) TFEU and complements other possibilities available to Member States to mitigate the social-economic impact of the COVID-19 outbreak in line with EU State aid rules, notably the possibility under Article 107(2) b TFEU to compensate specific companies or specific sectors for the damages directly caused by exceptional occurrences, such as the pandemic.

The 17th Florence Air Forum, co-organised by the Florence School of Regulation's Transport Area together with the Commission's DG Competition, examined the hard impact of COVID-19 on the air sector while exploring possible ways forward to ensure its recovery. More specifically, it sought to analyse whether special needs exist in the short- and mid-term period, until the Aviation Guidelines are reviewed.

Drawing on the policy debates, this brief explores investment aid and support to green investments for airports and airlines with a view to meeting the European Green Deal objectives. Furthermore, the brief looks at operating aid to regional airports, which have been particularly heavily hit by the crisis, and more specifically discusses how long these regional airports might need public support. Another aspect examined here concerns air connectivity, which constitutes an essential component of the European Single Market, as it can foster cross-border trade, promote economic growth and European integration. The pandemic's impact on the sector has raised concerns about a substantial loss of air connectivity. In view of this, the brief reflects on the need to adopt a temporary set of rules in the short-term to restore connectivity after the COVID-19 outbreak and to adjust existing rules on start-up aid in the mid- and long-term. Last but not least, this policy brief delves into the timely topic of remedies in mergers. A new round of consolidation in the industry can be expected as a result of the financial difficulties of many airlines. In order to protect competition, effective remedies will have to be identified.

Authors

Juan Montero, Matthias Finger, Teodora Serafimova

Issue 2022/08
January 2022

What role for competition rules when restarting aviation?

A comment by Juan Montero and Matthias Finger, Florence School of Regulation – Transport Area

The pandemic has forced the aviation industry to an almost halt in 2020, at least when it comes to the provision of passenger services: the number of active routes, as well as frequencies were substantially reduced; passenger volumes drastically declined. State aid was massive but asymmetric, benefiting airlines more than airports, airlines in Northern Member States more than airlines based in Southern and Eastern Europe, and large network carriers much more than regional airlines and low-cost carriers. All this challenged State aid rules to the point that the Commission had to decide on a transitory framework for State aid rules in 2020, in force until 2022. But this may not be sufficient, and in any case, it is highly likely that mergers will ensue. Furthermore, this transformation of the competitive landscape in aviation must be placed against the background of the "decarbonisation imperative", as well as in the context of pervasive digitalisation.

But the pandemic and especially its impacts are not over, and pre-COVID-19 passenger volumes may not return before 2024 or even 2025. What is more, the pandemic may well have accelerated certain underlying trends defining future air mobility, such as a substantial reduction in business trips as induced by digitalisation, new traveling patterns by digital nomads, a certain "shift to rail" in European inter-city travel, etc. Overall, digitalisation will constitute an additional source of uncertainty for the industry: even if digital technologies may well increase efficiency in most value chains, a more efficient coordination within the sector but especially across the different transport modes will probably trigger new connectivity alternatives and changes in travel patterns. As a result, new habits and lifestyles might have an even more profound impact on aviation.

On top of this, decarbonisation may have an even deeper impact on aviation: the currently proposed basket of measures to reduce emissions (i.e., alternative fuels, ETS, electric aircraft etc.) will inevitably increase the cost of travelling by air, in turn profoundly impacting prices and therefore demand. There are even calls for "managing demand", thus forcing the reduction in air travel through such means as the prohibition of certain routes when land transport is a viable alternative, etc.

In short, the aviation industry post-COVID will undoubtedly be different from what we knew. What does this mean for competition law to be applied in the air transport sector?

We think that these major transformations will have to be reflected in the application of competition law in aviation, and perhaps beyond: decarbonisation, digitalisation, new travel patterns, innovative business models, and many others more will require a more nuanced analysis and probably a review of the existing competition regulatory instruments. The role of competition authorities will be to foster, to the extent possible, a level playing field capable of ensuring that effective competition incentivises competitors to better adapt to the rapidly evolving challenges in an ever more turbulent environment. But what will this mean concretely for the regulation of competition in the air transport industry?

Clearly, the application of the rules on competition will need to be adapted to the new circumstances in the industry, and the different instruments (State aid, mergers, antitrust) will have to be applied in accordance with the new reality. But there is still a very high degree of uncertainty as to how the sector is going to evolve, and it may be advisable to simply extend the current transitory framework for State aid rules for another year or two. This will allow to better distinguish between structural and temporary changes. Already now, it appears that passenger reduction, for instance, is quite asymmetric, and it is not affecting all geographical areas and all types of travellers (business, leisure, etc.) in the same way, something that will call for a much more nuanced definition of markets.

Firstly, it is already quite obvious that much more public support will be necessary for the decarbonisation of the sector, probably in the form of investment aid for the decarbonisation of airports and aircraft, given that the COVID-19 crisis has dramatically weakened the financial capabilities and borrowing power of all industry players. Even though private investment has already started, public funds will be needed. Competition law instruments, and in particular the State aid rules, will have to take this phenomenal decarbonisation challenge into consideration. The inclusion of aviation in the proposed Climate, Energy and

Environmental State Aid Guidelines is a short-term decision to be taken. Carbon contracts for difference is a tool to be considered. We think that competition should be a force leading the decarbonisation transition, rather than the transition being a reason to exempt the industry from competition and competition rules.

Secondly, the rules pertaining to operating aid to airlines in the form of start-up aid will have to be reconsidered. While the Aviation Guidelines define the conditions for start-up aid, these rules have hardly been applied in the past, given that start-up aid in normal times should indeed be exceptional. But these are not normal times, and airlines will need a more flexible approach to start-up aid for the recovery period. And again, a more nuanced approach will be required, as not all airlines share the same business model. The type of aid for regional airlines serving smaller regional and remote airports is probably different from the type of aid required by low-cost carriers serving larger regional airports; routes serving large touristic destinations might benefit from incentive-based start-up tied to occupancy, whereas for routes serving remote areas start-up aid may be conditioned on the availability of service. Public Service Obligation (PSO) declarations and compensations, in turn, should also be analysed in light of the new circumstances of decarbonisation and alternative transport modes.

Thirdly, it seems clear already at this stage that the phasing-out in 2024 of State aid to regional airports, as defined in the State aid Guidelines, will have to be reconsidered, as COVID-19 has profoundly affected the financial capability of many regional airports to balance their accounts without State support. But, again, a more nuanced approach will be necessary: business travel, for example, seems to be recovering much more slowly than leisure; recovery also appears to be asymmetric in terms of geography. As the current temporary framework expires in mid-2022, new temporary rules for the recovery period will be necessary, and a more flexible approach to regional airport financing will have to be drawn up beyond 2024.

Finally, a new wave of post-COVID mergers can be expected during the coming months. These mergers, and perhaps even more so the response of the competition authorities, will shape the industry for decades to come. But in any case, further consolidation will be likely, making the EU aviation market increasingly resemble the US one.

Pressure to approve mergers in light of failing airlines will make the right definition of remedies even more relevant than in the past. However, the remedies of the past, namely making scarce slots available for newcomers, have not always proven effective. Whereas in congested airports, slots are indeed a real bottleneck, making them available for other carriers is an effective tool. However, in most European airports, slots are not the real barrier to entry for newcomers. As a consequence, slot remedies were not taken up by alternative carriers even years after the remedy was adopted.

More innovative remedies might therefore be necessary, namely remedies focused on the market failures created or reinforced by the merger. For example, if a merger creates a situation of super-dominance on specific routes and powerful network effects, ensuing competitive advantages could be shared, temporarily, with competitors, for example, in the form of interlining agreements and share code flights.

The air sector has embarked on and will continue pursuing a very profound transformation. While some effects of the pandemic are only temporary, requiring temporary adaptations of the rules on competition, others are here to stay as they reflect profound decarbonisation and digitalisation transformations. In this case, competition rules must be adapted. Such adaptations, however, should not diminish competitive pressure but rather strengthen these competitors that better respond to the underlying trends. It is not the role of competition authorities to protect the status quo but to ensure a level playing field for competitors to face the new challenges.

Main Takeaways from the Discussions

By Teodora Serafimova, Florence School of Regulation – Transport Area

Investment aid: How to support green investment to airports and airlines?

Broad consensus has recently emerged across the aviation industry, civil society, consumer and worker representative groups, as well as policymakers over the need to decarbonise the aviation sector in line with the European Green Deal objectives. Achieving net-zero carbon emissions in aviation by 2050 will necessitate a "basket of measures" to be pursued in parallel. These include the deployment of improved aircraft technologies, the optimisation of operational procedures (e.g., more sustainable and efficient flightpaths), the adoption of new legislation to support the development and uptake of sustainable aviation fuels (SAFs) and not the least, a reliance on market-based mechanisms (e.g., EU Emissions Trading System, CORSIA).

The first session of the 17th Florence Air Forum brought particular attention to SAFs, which are widely seen as the most promising means to decarbonise a significant part of the aviation industry, specifically the long-haul segment. Despite their enormous potential, SAF penetration rates stand at around 0.01% of global fuel usage today. This can be attributed to the fact that SAF prices are roughly 3 to 5 times higher than those of conventional fossil jet fuels. This, in turn, is due to manufacturing specificities, safety considerations and high degree of certification inherent to SAF production. SAFs' underlying production economics are more challenging than those of other renewable fuel types because, per unit of feedstock, current technologies typically yield less fuel, require more energy inputs resulting in very limited production capacity being prioritised for SAF. In this sense, a broad range of policy measures including the mobilisation of capital to expand SAF supply and to assist SAF facility operation are necessary. For SAFs to become more cost-competitive, fuel suppliers will require a stronger market signal to boost production for the aviation sector.

In view of this, the European Commission's Fit for 55 Package puts forward its so-called ReFuelEU Aviation initiative: a new legislative proposal on SAFs, which foresees a gradual increase in the blending obligation for fuel suppliers, coupled with a mandatory uplift obligation for all airlines departing from European airports. More concretely, the proposal foresees a 2% blending mandate for SAFs by 2025, 5% by 2030 and 20% by 2035. Three different risks would need to be managed in order to attract investment into SAF production, namely demand signal risk, capital risk and price risk. Whereas stakeholders welcomed the EU SAF mandate as particularly helpful in providing the demand signal, they cautioned it does not sufficiently address the capital risk and the price risk. In view of this, some participants cautioned that, on its own, the SAF mandate would not guarantee that the necessary SAF production takes place locally in Europe.

By comparison, the US, which has announced an ambition of 100% of SAFs by 2050, was said to be one of the most advantageous regions to produce SAF thanks to the government's provision of direct financial support and investment incentives, such as loan guarantees, federal subsidies and tax benefits, for high risk SAF projects. For example, qualified producers or blenders of SAF derived from biomass have access to the US' Blender's Tax Credit. In particular, it provides a tax credit of $1 per gallon (up to $300 per ton) of biofuels produced or blended in the US. This scheme has been vital for the production and scale up of SAFs in the US. As a result, SAF in the US was said to be almost at cost parity with fossil kerosene. Drawing on this, participants expressed concerns that US aviation could be placed at a significant advantage over EU based carriers due to their access to a growing volume of low cost SAF enabling customers to buy low carbon flights at an affordable price.

The UK, too, announced in October 2021 a new SAF policy with a view to becoming a leader in zero-emission aviation. The UK foresees the development of a SAF mandate, to enable the delivery of 10% SAF by 2030. To support their development the government has announced GBP 180 million worth of funding. In view of policy developments in different parts of the world, participants stressed the need for Europe to secure investment for SAF production in order to mitigate the risk of production moving offshore.

The mandatory uplifting requirements for SAF at EU airport hubs (and not at external non-EU hubs)

was perceived by some as a risk for the competitiveness of EU hub carriers. In view of this, it was argued that policymaking would be most effective at the global level (e.g., at the ICAO level), mitigating the risk of competitive distortions and providing the clearest possible signal to support investment in SAF and alternative propulsion technologies. Participants echoed the need to push for greater ICAO ambition on a global SAF target at the upcoming 2022 General Assembly, with an extension of the SAF mandate's scope to extra-EU flights only to be considered in the case of limited progress achieved through the ICAO. Attention was brought to the fact that the debate on securing a "level playing field" is not only applicable to the interrelation between EU network carriers vs non-EU network carriers, but also to intra-EU traffic, where low cost carriers (LCCs) account for the majority of traffic flows. In other words, some participants underlined that the introduction of an EU-focused SAF mandate could risk diverting such traffic away from EU to non-EU countries (e.g., North African region), for instance.

Stakeholders welcomed the fact that the Climate, Energy and Environmental Aid Guidelines (CEEAG) provide for contracts for difference (CfD), which are contracts entitling the beneficiary to a payment equal to the difference between a fixed and a reference price. In the UK case, CfD have proven especially successful in commercialising and bringing economies of scale for renewable power by creating price stability to generate necessary investments. Ensuring price stability is a particularly crucial precondition for high risk investments such as SAFs, where we see strong competition for the various types of feedstock, which can be used for different types of renewable fuels, but also for the various pathways to produce SAFs. CfD are an attractive means to bring much needed price stability and de-risk investments.

Scepticism was expressed as regards the need to include support for SAF infrastructure in the revised CEEAG guidelines partially because SAFs rely on the same airport infrastructure as conventional fossil jet fuels. What is more, some stakeholders were cautious about granting subsidies to downstream users (i.e., airlines) to promote the use of SAFs, given that this would amount to operating aid, which has a distortive effect on the market (discussed in more depth below). Having said that, stakeholders were more receptive towards the inclusion of subsidies in the revised CEEAG guidelines intended for the production of SAFs, thus targeting stakeholders higher up the chain.

The discussions, furthermore, dove deeper into the specific role of airports in the greening of the aviation sector more broadly, thanks to their unique position as an 'interface' between various operational stakeholders, from airlines, to air traffic managers (ATM), SAF producers and energy suppliers. Despite having relatively negligible contribution to overall CO_2 emissions, airports' indirect effect can be relevant or even strategic when it comes to so-called scope 3 emissions. To put things into perspective, in the case of Milan Airport, for example, in 2018 airport processes (scope 1-2) accounted for only 6% of total emissions, whereas the landing and take-off cycle (scope 3) was responsible for 34%. It should be noted that between 40% and 60% of emissions related to airport activities derive directly from road traffic and airport accessibility. In view of this, participants stressed the need to incentivise sustainable passenger transport to-, from- and within the airport premises, such as railways and electric vehicles (EVs).

Furthermore, stakeholders acknowledged that airports can resort to readily available technologies and procedures to deliver considerable emission reductions. These include measures targeting the construction and operation of terminal premises, such as the rollout of electric ground service equipment and battery EVs, coupled with the necessary charging infrastructure and power supply on the airside. The switch to more efficient Air Traffic Management (ATM) procedures including through the implementation of the Single European Sky (SES), which would involve airports at least for the landing and take-off cycles, also stands to deliver quick wins. For instance, the implementation of more direct flightpaths could reduce up to 10% of air transport CO_2 emissions. Bearing in mind the long average life cycle of aircraft and ground handling equipment, fleet renewals will have to be significantly accelerated, though these come with significant upfront investments. The current CEEAG provide incentives specifically for aviation, such as subsidies to airlines for the renewal of their aircraft fleets, and subsidies to airports for the switch away from diesel-powered ground handling equipment towards one that is electrically powered. Pointing to the fact that these subsidies only amount to the difference in the price between new and conventional fuels,

stakeholders questioned whether this provides sufficient incentives for the market to move towards green mobility.

The Fit for 55 Package introduces new obligations for the aviation sector, including for the airlines and airports. Airports, for instance, would need to provide electricity at stands to aircraft (i.e., Alternative Fuels Infrastructure Regulation) and take on an active role in the provision of SAFs (i.e., ReFuelEU Aviation Initiative). Compliance with these new obligations inevitably comes with an additional cost, though the CEEAG typically do not foresee State aid in order to meet a legal obligation. Some stakeholders were thus in favour of allowing State aid in relation to compliance with the Fit for 55 Package obligations, in particular to support early adopters of the above-mentioned measures and technologies, which they argued would be key to kick starting the market.

Besides SAFs, over the course of the next 10-15 years hydrogen and electric aircraft are likely to start playing a more prominent role, especially for the short-haul and regional segment. Here too, airports will have a key role in the deployment of electricity and hydrogen, which will have to be supplied at their premises at the right time, price and quantity. When it comes to electricity, stakeholders noted that it could be technically feasible to supply at high voltage, however, the shift to industrial deployment of disruptive technologies (i.e., electric, hydrogen, hybrid) would necessitate more funding at European level. What is more, stakeholders urged the need to ensure that the cost of SAFs and fossil jet fuel are equalised at airports. Government support should thus target industry investments by means of direct stimuli or by reducing investment risk through a consistent and long-term policy framework. Close collaboration with the energy sector will be necessary to ensure sufficient availability of renewable energy at affordable cost.

Currently there is an assumption that greening investments' higher costs are passed through from the airports to the airlines in the form of higher airport charges, and subsequently from the airlines to the passenger in the form of more expensive flight tickets. The ability to pass costs through is not uniform across all airports, however. Some stakeholders, for instance, noted that for hub airports it is much easier to pass through the cost of investments than for smaller or regional airports, because of the market power that airlines exercise upon them. Moreover, stakeholders pointed out the inherent tension between economic regulation and the greening of aviation. To illustrate this, the access to the aviation market today is regulated by various regulations, including the Ground Handling Directive, the Slot Regulation, and the Airport Charges Directive, all of which govern access to infrastructure. Drawing on the ongoing debate about the modulation of airport slots and charges on the basis of green criteria (e.g., air and noise pollution, CO_2 emissions), some participants were doubtful as to whether these are the most appropriate instruments to foster the aviation sector's greening.

In conclusion, participants stressed the importance of approaching the revision of the State aid guidelines from a broader perspective on the entire transport "system", in view of the need to better balance investment needs across the various sectors and modes. Furthermore, some participants urged that, if granted, investment aid should be linked to concrete efforts to mitigate the effect of aviation on the environment. Such efforts could be broader than a mere focus on SAFs deployment, to include modal shift for instance (e.g., replacing short-haul flights with train journeys). In parallel, policymakers should pursue internalisation measures to ensure that transport reflects its true costs. The Fit for 55 Package seeks to rectify this in the aviation sector by revising the Energy Taxation Directive. Whereas customers are increasingly demanding greener aviation, some stakeholders expressed concerns regarding consumers' actual willingness to pay more for flying. To illustrate this point, it was noted that only ca. 1-2% of customers today are paying more to contribute towards the CO_2 offsetting of flights despite the various opportunities being offered.

Operating aid to regional airports

Under the Aviation Guidelines, adopted back in 2014, operating aid is linked to the size of airports, whereby the assumption is that smaller airports face greater difficulties in becoming financially viable than bigger airports. For this reason, operating aid to the smallest airports (i.e., those with less than 200 000 passengers per year) is foreseen under the General Block Exemption Regulation (GBER). This means that Member States can grant State aid covering the operating losses of those airports, without the

need to notify it to the Commission. Moving up to airports from 200 000 to 3 million passengers per year, the current Aviation Guidelines foresee a possibility to grant operating aid to regional airports for a 10-year transitional period until April 2024. The initial intention behind this 10-year transitional period was to enable these airports to figure out their business model with a view to becoming viable without public support.

With this 10-year transitional period soon coming to an end, some stakeholders urged the need to revisit the initial plan in view of regional airports being among the worst hit by the COVID-19 crisis, whilst needing to be sustained in order to maintain connectivity.

Prior to the onset of the pandemic, the Commission conducted a Fitness Check to better understand whether there is a structural need for operating aid at some airports after 2024. The Fitness Check revealed a mixed picture. In principle, it found no more need for operating aid for airports with over 700 000 passengers per year as these are expected to be cost-covering by 2024. However, the Fitness Check showed that operating aid would continue to be needed for roughly 63% of the small airports with less than 200 000 passengers per year, which are unlikely to be cost covering by 2024. Therefore, the block exemption for operating aid for the very small airports appeared to be justified, according to the Fitness Check findings. The picture becomes more nuanced when it comes to airports with passenger traffic between 200 000 and 700 000 annually where the Fitness Check showed that 69% of the airports would be viable without operating aid by 2024. A large part of these airports were thus on track to becoming fully cost-covering by 2024 before the pandemic hit, but not all of them.

The regulatory and market landscape in which the aviation sector operates has dramatically changed since 2014. Whereas some projections estimate that Europe will see a full recovery, back to pre-COVID-19 levels, in 2023, others only expect that to happen by 2026. The differences in scenarios can be explained by the fact that some estimates are based on flight numbers whereas others measure passenger numbers at airports.

Furthermore, full recovery will not occur at the same time for all airports, and will likely depend on the size of the airport in question, the type of airline that is serving the airport, and the airport's business model, among other factors. While German airports are mainly outbound and thus compete for outbound traffic, remote islands or the Alps region, for instance, are characterised by inbound airports as passengers travel to these destinations for holidays. Therefore, airports can be specialised in and compete for different types of traffic.

Some key questions this session sought to address included the extent to which COVID-19 has impacted airports' economy and capital, and whether these impacts can be said to be merely short- or medium-term in nature, thus expected to eventually disappear allowing airports to return to their pre-COVID-19 path as found by the Fitness Check. Conversely, discussions examined whether and the extent to which the sector would change in a structural way. Indeed, whereas passenger traffic may recover to pre-pandemic levels, some parts of business travel may never return to pre-existing levels or even disappear due to changes in corporate policies (e.g., increase in tele-conferences, travel by rail only). Such structural changes will inevitably affect the economy and sustainability of airports, putting pressure on the business model of regional airports in particular.

Whereas on the one hand, stakeholders were aligned over the need for a clear policy on operating aid well ahead of the 2024 deadline in order to ensure legal certainty for airports and financial institutions alike, some acknowledged that a revision of the Aviation Guidelines might be more timely once the pandemic induced "dust has settled". Pointing to the five years' worth of traffic lost as a result of the pandemic, some participants called for an extension of the transitional period. Whereas no clear conclusions were reached as to whether the review process should be postponed to a later point in time, stakeholders acknowledged its necessity to address a number of issues. The first one relates to notifications. Since the entry into force of the Guidelines, regional airports and Member States have submitted only eight notifications of operating aid over the course of 7 years. Such a low number, however, does not correspond to demands voiced by the sector regarding the need for continued operating aid to secure its viability. This, in turn, has put into question the necessity and legality of the granted operating aid, while making the justification of continued operating aid more difficult.

Another key issue that the discussions explored relates to the underlying factors that render some airports loss making and others not. There can be different reasons behind an airport's lack of financial viability, which in turn, may influence the most appropriate instrument to be applied. This, in other words, means that operating aid may not necessarily be the only or the best instrument. To illustrate this, a given airport may not be viable because its host region is underdeveloped, thus making it difficult for the airport to attract sufficient traffic volumes both in terms of tourism and business. In such cases, as opposed to granting operating aid in perpetuity, a more fitting approach may be to tackle the issue at its root by supporting the development of the region with a view to increasing traffic to the airport. Another key element raised was the resilience of airports to shocks. Some regional airports are largely dependent on a single airline, which places the airport in a particularly vulnerable position (e.g., in case the airline goes bankrupt or chooses to leave the airport).

Some stakeholders, however, noted that airports, as fixed infrastructures, face particular difficulties in cutting down their operating costs. Their ability to do so has been exacerbated by the COVID-19 pandemic, which has resulted in higher non-economic activity costs linked to health measures at airports and limited non-aeronautical revenue due to lower passenger traffic. In fact, it was noted that while airports have slashed operating costs by 24%, revenues generation has lagged behind 60% since the pandemic. In view of this, some stakeholders argued in favor of increasing the GBER threshold from the current 200,000 to 700,000 or 1 million passengers per year. They also supported an increase of the maximum operating aid intensity to 80% (vs 50% currently) for airports between 700,000 to 1 million passengers per year in the Aviation Guidelines beyond 2024. Such an increase in the thresholds and aid intensities, it was argued, would help to enable recovery and address the investment crunch. More generally, some stakeholders questioned whether the current rules on operating aid (on the basis of airport size and passenger numbers) were granular enough. Instead, the introduction of more refined rules based on various factors, including regional development was therefore called for.

So-called "sweetheart deals" between airports and airlines were identified as another root cause of airports' viability issues. Sweetheart deals are problematic for airports themselves as they may not always be profitable and may even generate losses, which in turn, result in the need for operating aid. The (mis)use of operating aid to finance sweetheart deals, which primarily benefit airlines, goes against the essence of granting operating aid to airports. What is more, participants warned about higher risks of such misuse of operating aid in the post-COVID-19 period, as airports with limited financial capacity are confronted with volatile airline capacity and planning. In addition, the ongoing consolidation in the market, whereby LCCs are growing and network carriers reducing their fleets is resulting in airports having fewer possibilities to attract airlines. Airports are being approached by network carriers and LCCs alike with requests for long-term rebates. A potential distortion of competition could derive not only from the aid that may be generated by the airlines concerned by such sweetheart deals, but also by the fact that other regional airports will not be able to attract equal traffic volumes. In defense of sweetheart deals, some stakeholders clarified that these deals are not inherently distortive, and have in fact been highly beneficial for many airports across Europe. For instance, Bergamo and Charleroi, being two of the most profitable European airports today, have relied on sweetheart deals to kick-start their traffic flows initially.

Given the "general public interest" nature of greening and infrastructure development investments, some stakeholders argued that State aid can, in principle, be compatible with the internal market without distorting competition. This, it was noted, holds true as long as the underlying access conditions to the infrastructure in question respect the principle of non-discrimination, deriving from international law and stated in Article 3 of the Airport Charges Directive. Within this context, incentives which act to boost traffic to airports (e.g., rebates, discounts concerning with launch of new routes or schedules, or to incentivise greening), could be considered in line with State aid rules if these are available to all airlines in a non-discriminatory manner. Drawing on the above, some stakeholders underlined that "sweetheart deals" between airports and airlines cannot be exclusive to some airlines only. Therefore, the conditions granted to the airlines in these agreements, must be made publicly available to all airlines, which intend to operate in the given airports.

Furthermore, some stakeholders stressed the need to ensure that incentives for startup businesses (e.g., new routes and schedules) are granted for a limited period only. The beneficiary airlines must submit evidence in the form of business plans demonstrating that such new routes will be profitable. The incentives to the startup business must be proportional to cover actual costs, thus avoiding any overcompensation. When it comes to regular operating aid to regional airports serving remote or peripheral regions (e.g., islands) with no efficient alternative public transportation, stakeholders agreed that the compensation must be applied under the Public Service Obligation (PSO) mechanism foreseen under EU law.

Discussions also drew attention to the issue of cross-subsidisation of regional airports' operating costs, which could cause airline competition distortion in the Single Market. As a result of the indirect effect of subsidising regional airlines' operating costs, the cost burden could be transferred to airlines not operating in the given airport. Some stakeholders urged the need to reconsider the definition of "airport network" foreseen in Article 4 of the Airport Charges Directive, which was said to be too broad in its current form. Consequently, Member States today are resorting to their own definitions without any binding obligations to comply with set criteria (e.g., in regards to type of relationship and interaction between the airports). In the case of Portugal, for instance, "airport network" is defined on the principle of solidarity.

Going forward, a key question to be addressed is whether the continued provision of operating aid to airports, which are structurally not viable, can be justified given the sector's contribution to climate change. On the one hand, the substitution of flights with high-speed or night trains has proven to be possible, especially over shorter distances, as illustrated by the case of France and Italy. On the other, it is also clear that these are mere exceptions, given the underdeveloped railway infrastructure that would be necessary to provide regional connectivity and replace flying. Discussions in this session revealed that the post-COVID-19 outlook remains uncertain, thus undertaking a substantial review of the Aviation Guidelines may not yet be productive. However, stakeholders expressed support for a new bridging period until at least the aviation sector has returned to some sort of new normal, which is to be followed by an eventual review.

Connectivity needs

Over the past two years we have observed a reduction in passenger travel as a result of imposed lockdowns and travel restrictions, but also because the transport network has been significantly reduced (due to cancelled routes). Despite persisting uncertainty and volatility, air passenger traffic is slowly starting to show signs of recovery, with roughly 70% of the air passenger traffic levels of 2019 expected to be reached by end of 2021. However, as made clear above, not all segments are witnessing the same pace of recovery, with the heterogeneity transcending beyond leisure and business travel. Another emerging trend has been "bleisure" (i.e., a combination of business travel and leisure), which appears to have been hit hardly by the pandemic.

One key challenge going forward will be to restore public confidence, while rendering aviation more sustainable (in terms of economic, environmental and social sustainability). From a competition law perspective, State aid for airlines was broadly welcomed and perceived as needed, though it was also agreed that it should come with conditions to ensure public funding is well-spent and aligned with the European Green Deal objectives, and supportive of the Fit for 55 Package. What is more, the granting of State aid should adhere to strict social obligations towards both staff and passengers. All State aid should, furthermore, be guided by the principles of market efficiency and connectivity. In this spirit, if more environmentally and economically efficient alternatives exist today (e.g., railways) then the continuing granting of State aid to air travel could no longer be justified. Drawing on this, some stakeholders reminded that transport is an integrated system, which in turn, should form a key consideration when debating the most appropriate regulatory and funding measures to restore connectivity.

More generally, discussions sought to clarify what is meant with the term "connectivity" and when it should be appropriate to consider State aid as an instrument to restore a loss in connectivity. While some routes have not been re-opened yet, others have seen a reduced frequency post-COVID-19. The routes that have survived throughout the pandemic have demonstrated their vital nature for the network of today. For some routes, on the other hand, alternatives exist which may not be well known

or taken advantage of today. Where demand is not sufficient to leave it up to market forces, then scope exists for PSOs, which should serve social needs and be based on sound cost-benefit analysis (taking into account all aspects, not only economic but also social and environmental).

Stakeholders also underlined the need to understand the root causes (e.g., less demand) behind the loss of connectivity when discussing possible solutions. For instance, when it comes to routes that have seen a drop in demand, some participants questioned whether airlines could switch to smaller planes in order to render such routes profitable again.

The restoration of connectivity in practice calls for measures to ensure that this connectivity is visible, bookable and available to consumers. In view of the fact that the starting point of most searches nowadays are digital all transport options would need to be made visible across all digital channels transparently so that consumers can make informed decisions. While affordability is central to passengers, prices should also reflect the true environmental cost and the basis on which the prices are calculated should be similar across all transport modes. Transparency and full information will be essential to not only facilitate connectivity, but also empower the traveller to make sustainable travel choices. Conversely, travellers may be precluded from enjoying existing routes if these are not digitally available.

This session's discussions revealed that a certain rethinking of connectivity may be necessary. The traditional point-to-point connectivity assumes an air route that connects two points either directly or indirectly. Today we are increasingly looking at collaborative connectivity, whereby passenger trips combine networks of multiple transport providers. In aviation, this manifests itself in the form of codeshare and interlining, but also multimodal trips. Active modes will also need to be included in the collective transport network and point-to-point view. The third layer is the digital connectivity where travellers can find, transparently compare and purchase trips through their channel of choice, across multiple channels globally. A provider agnostic approach to routes and sales channels was highlighted as key to securing non-discrimination.

Stakeholders urged the need for the regulatory framework to enable fair access to transport content, with a view to facilitate both connectivity and consumer choice. For instance, proposals were put forward for the inclusion of content obligations in State aid measures so as to stimulate digital connectivity and increase collaboration among all transport providers. Proponents of such an approach held that State aid could be used to foster a positive interaction between transport modes so that a collaborative environment is created, which provides visibility to SMEs under the same market conditions as hub carriers. In this regard, stakeholders pointed out the Commission's ongoing initiative, which seeks to establish multimodal digital mobility services (MDMS) so as to better integrate public transport and rail services and thereby achieve seamless multimodal passenger transport, delivering the European Green Deal. Facilitating data sharing across the different transport modes will be key to enable multimodal digital mobility service providers. While multimodal connectivity platforms and digital mobility are key emerging trends, participants agreed that the main barriers to be resolved here are not financial (i.e., market failure justifying State aid) but rather regulatory in nature (i.e., incumbents hesitant to sharing data). Thus, the priority going forward would not concern public support but rather regulation and getting operators to collaborate and understand the benefits behind establishing platforms.

Discussions zoomed in onto regional air segment whose connectivity has suffered particularly much as a result of the pandemic. The regional air transport market in Europe operates around 1,555 routes under 500km, with the traffic being much thinner than broader carriers. The regional segment is marked by lower economies of scale, low return on assets, and higher costs of providing regional services, both for airports and airlines. With fewer passengers across whom fixed costs are spread this means higher per passenger operating costs for smaller aircraft. Smaller operations are also proportionately less supported with COVID-related public subsidies and incentive schemes than bigger airlines, participants noted. With 97.32% of all insolvencies involving airlines with 40 aircraft or less, regional airlines have been primary victims. Though airport charges have been mostly frozen for the period 2020-2021, their expected increase in the coming years is set to further complicate what are already fragile economics of the regional air sector. On the other hand, the aircraft used for regional routes are smaller, thus having a lower

environmental impact in terms of CO_2 emissions. What is more, the regional air segment plays an important role as testing ground for disruptive zero emission technologies.

Despite recent announcements by several countries (e.g., France, Belgium) regarding the replacement of short-haul flights with train journeys, stakeholders cautioned this is not always a feasible alternative and can often come at the expense of longer trip duration. To put things into perspective, currently there are no flights in Sweden where the same destination can be reached within 2.5 hours by other transport modes. In Norway, on the other hand, the flight between Vadso and Kirkenes only lasts eight minutes, whereas driving the same distance would take approximately two and a half hours (provided favourable weather conditions and operational road crossings). In view of the above arguments, participants acknowledged the need for dedicated public support for the regional air segment both at the Member State and the EU levels.

In terms of concrete recommendations for the review of the State aid guidelines discussions showed support for an extension of the Temporary Framework beyond 2021 and continued aid to limit market distortions. Furthermore, some participants called for new conditions for start-up aid open to all airlines with more flexibility on incentives (e.g., increasing current cap at 50% of airport charges) and duration of the support (over 3 years). Another proposal was to expand the notion of public remit activities whose costs are to be borne by EU Member States. The provision of emergency PSOs routes and the review of the criteria (frequencies etc.) governing PSOs operated commercially prior to the crisis was also supported. Not the least, stakeholders suggested an extension of the compensation for damages under Article 107(2)(b) TFEU to include health protection and sanitary measures linked to containing COVID-19.

Taking a step back, participants recalled that some 30 years ago we had a system where a limited number of national legacy airlines flew passengers from one part of Europe into their respective hub airport (e.g., Heathrow, Paris) and onto their destination (sometimes even transiting via another airport). Today we enjoy direct regional connectivity thanks to the liberalisation of the European aviation market, which has allowed LCCs to enter and expand in all European regions. This has enabled passengers to reach their destination by taking one single flight, which in turn, has important benefits in terms of time, cost and emission savings. In view of this, some stakeholders urged the need to break away from the belief that legacy flag carriers are essential to ensuring connectivity and thus need to be protected and subsidised at all cost. Since the start of COVID-19, however, over €30 billion in State aid has been allocated to legacy carriers, whereas LCCs have received no public support, despite providing greater connectivity in terms of market share. LCCs, on the other hand, have not received any public support, and have resorted to private rescue packages. Though long-haul carriers have been the main recipients of State aid during the pandemic, they are excluded from the scope of the EU ETS, and only pay for CORSIA, which is roughly 5 to 10 times cheaper than the EU ETS, some participants underlined. These same airlines are also exempted from the scope of the proposed jet fuel tax as part of the Fit for 55 Package.

Participants noted that the above-described approach has exacerbated the situation across Europe where legacy carriers already enjoy widespread national protectionism, whether that is in the form of delaying the reinstatement of slot usage rules or the artificial constraining of airport capacity. Furthermore, some stakeholders pointed out the misconception that a legacy carrier's exist from the market would leave a void that no other airline could fill. To illustrate this point, participants recalled the case of Hungarian flag carrier Malev's bankruptcy back in 2012, following which LCCs flooded into the market and Wizzair set up its base in Budapest airport with only two weeks' notice, bringing in more passengers, capacity and routes as compared to when Malev served it.

In response to the above arguments, it was clarified that EU State aid rules were not inherently designed to favour hub carriers, and prior to the pandemic no operating or investment aid was approved by the Commission to hub carriers. Furthermore, it was pointed out that companies who were on the receiving end of aid under the temporary framework, were not in economic difficulty before the crisis. Furthermore, some stakeholders recalled the limits of the EU competences under the State aid guidelines, given that in the end of the day it is national governments taking decisions as to which carriers to support.

Some other stakeholders, on the other hand, urged the need to take broader view of the global aviation market, where hub carriers play a key role in connecting Europe to the rest of the world. Failure to ensure the competitiveness of the EU hub carriers on the global stage, some participants noted, could result in a scenario where Europe's connectivity is determined by third countries' flag carriers. What is more, participants urged the need for a broader view of connectivity which looks beyond passenger traffic in Europe, to consider global air freight traffic. In other words, subsidising legacy airlines has not only been about securing passenger transport, but also about upholding global supply chains during the crisis. Air cargo has been particularly critical in ensuring supplies of vaccines, medicines and other essential goods, during the Suez canal crisis.

Remedies in Mergers

Consolidation has been part of the daily life of aviation even before COVID-19. Indeed, there is a long list of airlines that have exited the market or have merged with other entities over the past 15 years. In fact, the five largest air carriers today account for more than 50% of the total European air traffic. The pandemic has left many aviation sector players in weakened financial situation as a result of which it is likely to expect a new wave of airline mergers and consolidation in the industry, possibly raising competition concerns. In view of this, the forum provided a timely platform for discussion on the EU approach to remedies.

Participants broadly agreed that consolidation does not necessarily need to be negatively perceived given that it often brings about greater efficiency and resilience. Consolidation can also facilitate connectivity if it enables hub carriers to maintain the connectivity both intra- and inter-EU (referring to both passenger and cargo traffic). Larger carriers can reap economies of scale to produce at lower cost per unit thus strengthening balance sheets and the ability to invest in more efficient aircraft and disruptive technologies. However, consolidation needs to be approached with caution in order to ensure that it has a positive effect also in terms of ensuring that benefits are passed down to passengers as markets remain competitive.

Airline mergers to date have been approached on the route-by-route basis, with a view to understand overlaps on individual routes and significant impediments to competition. On this basis, the Commission has designed remedies in order to resolve competition concerns that have arisen. DG COMP has looked at airport-to-airport dominance on account of the merger to see whether the merged entity makes it exceedingly difficult for other suppliers to access the infrastructure. This has been especially interesting at congested airports where incumbents already control a high share of the capacity.

Making slots available to competing airlines on routes of concern as a means to ensure that competition is upheld has delivered mixed results. In many cases, slots have not been picked up (e.g., AF/KLM, LHG/AUA, LHG/Brussels, Alitalia/Etihad). Germany stands out, in particular, where slot remedies have never been picked up by competitors to compete with German airlines.

Stakeholders identified a number of factors that can explain why slot remedies have not always been successful. Firstly, competing against an incumbent airline, which post-merger has become even stronger, in a hub airport can be difficulty and thus economically unattractive. A second reason could be the value of the slots themselves, as these may be prohibitively expensive. Third, for rather evident reasons, slot remedies in non-congested airports may not be an attractive offer if these are abundant anyway. In fact, it was noted that few airports have slot constraint issues, or a complete shortage of slots even at peak times. Not the least, slots require heavy monitoring which can be burdensome and wasteful. While today so-called "sunset clauses" have been introduced along with slot remedies to ensure that they can only be picked up until a certain period, this was not a practice in the past, as a result of which there are 17 year old remedies, which are still being monitored today. Grandfathering was subsequently introduced with a view to allowing the use of slots for other more profitable routes after some time, meaning that you do not necessarily have to fly the route of concern.

Focusing on the route-by-route basis has shown to be particularly problematic where you have mergers with many routes concerned as it can be challenging to find slot remedies to cater to all these routes concerned. Some stakeholders thus argued that the EU approach to remedies should also address the supply side (i.e., access to the airport), not only the demand side. From

a supply perspective, this could take the form of allowing a competing airline to establish a base at an airport where you have several routes of concern. This would then enable an airline to compete with the merged entity on the basis of the base airport, without necessarily linking this remedy to flying the routes concerned. This would ensure there is a credible competitor with a base at the airport with a possibility of operating the routes of concern should the merged entity raise prices above what is reasonable or competitive. Stakeholders held that the mere potential threat would be sufficient to discipline any negative outcome of the merger on routes of concern at least in some cases. The base commitment was broadly welcomed as the right approach going forward given that it leaves it up to carriers themselves to decide which network is the most efficient to operate.

An analogy was made to re-capitalisation cases under the temporary State aid framework, where airlines are asked (as a compensation for the re-capitalisation they receive) to allow for the establishment of a base for a competitor at the airport. Here we do not talk about a merger but about re-capitalisation, which benefits the company in its entirety (i.e., all operations and routes the company is operating). Though the analytical framework is different, there is already some familiarity on the part of the Commission with the base remedy concept in the area of State aid. Some stakeholders argued that the accumulation of excess profit by airlines is highly unlikely, in view of the fact that unmet demand is rare and short-term in nature. Instead, they urged the need to focus on the barriers to entry (e.g., access to slots, competitive presence and viable scale) as this is where the harm can arise.

While there are no global consolidations because of ownership and control regulations that are in place, stakeholders warned that a purely domestic view on remedies in mergers risks overlooking the importance of intercontinental traffic. Intra-European traffic is dominated by low-cost business models. There has been a considerable growth in intercontinental passenger traffic from and to the EU over the past 10 years. However, it has been primarily non-EU airlines that have benefited from this growth. Already, pre-crisis roughly two thirds of intercontinental growth in the passenger segment was captured by non-EU airlines. As a result, in 2019 ca. 57% of the EU-intercontinental traffic was dominated by non-EU airlines. Competition outside the EU should thus always be at least in the back of our minds when talking about remedies and mergers. In particular, some stakeholders argued that initiatives part of the Fit for 55 package (e.g., EU ETS revision, upcoming SAF mandates) would lead to higher prices for customers on both short- and long-haul flights, with negative implications for the profitability and viability of EU carriers.

To illustrate this, parallels were drawn to the crisis in the European banking sector in 2008, which too was succeeded by a high degree of regulation of companies, and leading to them being disadvantaged them vis-à-vis US and Chinese banks. In view of this, some participants cautioned that the EU remedy policy must factor in the competitiveness of the EU airlines on a global scale in order to avoid similar detrimental effects on the long-term competitiveness of the EU aviation sector.

While slots divestiture has been the main remedy used to date by competition authorities in airline mergers, limited attention has been paid to the downstream, namely the distribution level. Distribution-related remedies were welcomed as a new avenue worth exploring with a view to safeguarding transparency to facilitate entry on the market and competition. Intermediaries in air ticket distribution (i.e., OTAs, metas, GDSs, TMCs) can provide transparency to consumers, allowing the traveler to compare all available options (i.e., price, services, environmental footprint) on unbiased marketplaces. This enables inter-brand competition whereby new entrants can compete directly on merits with incumbents and attract potential new customers, thus lowering entry costs. In parallel, intra-brand competition is also possible as intermediaries can compete with airlines' direct distribution channels by offering discounts to their customers and providing improved searching and booking experiences. Such intra-brand competition is not fostered by slot divestiture, which targets only competition with new entrants.

Indirect distribution channels can act as competition enablers provided that they have non-discriminatory access to "quality" contents i.e., their lowest fares, core ancillary services. Some participants, however, claimed that large dominant EU airlines have implemented abusive conducts over the last decade targeting indirect distribution to limit transparency for consumers. These, it was argued, have taken the form of surcharges

on tickets purchased via GDS channels, the withdrawal of basic fares from GDSs, and ancillary services not made available to indirect channels, among others. Other stakeholders, on the other hand, held that abuse of dominance by airlines when it comes to distribution channels could not be substantiated, and that no evidence exists to demonstrate any obvious harm to consumers arising from the direct distribution model.

Time for the great SAF Rush

A comment by Niamh McCarthy, Head of Competition Law at International Airlines Group (IAG)

The COVID-19 pandemic has hit the aviation industry hard. But as airlines chart a path to recovery, part of their return must include reducing the industry's contribution to climate change. Sustainable aviation fuel (SAF) is a key part of the aviation industry's plan to reduce carbon emissions in the coming decades. Yet SAF production today is just 0.1 percent of overall jet fuel supply. The good news is that from a technical perspective, sustainable fuels can become the new normal, growing to 20% volume in use by 2035 in the EU. Also, many recent models point to about two-thirds SAF in use by 2050, provided we can incentivise the wider-spread production of the fuels.

Indeed the International Aviation Climate Ambition Coalition at the COP26 in Glasgow in November 2021 has committed to the development and deployment, through international and national measures, of sustainable aviation fuels.

The ambition is there, but right now we don't have the supply; at least not at the scale that is required. And to achieve that scale will take real partnership from airlines, fuel providers, and policymakers to build an entire ecosystem for sustainable fuel from scratch. That includes every link in the supply chain: from the initial facilities, where sustainable materials are processed to the plants, where the fuel is refined to the delivery of the fuel to our EU airports. But the good news is that the SAF is "drop-in" meaning that it is chemically very similar to fossil jet fuel, so it can simply be mixed into existing storage, pipelines and aircraft.

We need the policies and the right incentives from governments to support the investment and in particular, to deploy the necessary capital to ramp up production to address the high price of SAF, which is the single biggest operating expense for airlines. Even though the demand signal is there through mandates and commercial commitments, it is nonetheless estimated that SAF production will require significant public financial support in the range of €120 billion over 15 years.

SAF mandates are important but not enough

The EU ReFuel mandate though it does provide a clear demand signal, will not of itself deliver the necessary capital investment to spur wide-scale commercial deployment of SAF. The mandate must be accompanied by other positive measures such as the allocation of public funds to help reduce the price gap between SAF and conventional jet fuel.

Nor are Airline Offtake agreements enough on their own

Similarly, traditional offtake contracts aren't enough to spur more SAF production on their own. The issue is that the price sensitivity within those contracts is such that they are saying if you can produce it at a price comparable to current opportunity, then we'll buy as much as you can produce. The issue is that this is not sufficient today to deploy more production because there is still an incremental expense that needs to be overcome.

That is where EU State aid policy can help to introduce price stability mechanisms. For example, contracts for difference (CCfDs) which entitle the beneficiary to a payment equal to the difference between a fixed and a reference price, have proved very successful in commercialising and bringing in economies of scale for UK's renewable power. In this respect, the clarification in the CEEAG that aid for decarbonisation can take the form of contracts for difference is to be welcomed.

Closing the incentive gap with other fuels

Another factor limiting investment in SAF has been a gap between how aviation and other fuels are incentivised. Investors want to have security into the future of consistent policy that will support their activity and their return on their investment. And today, we don't have that. It's uneven with regard to what types of fuels are being incentivised. Producers look at the marketplace and see which is going to give the best return. Today, policy has skewed more towards ground transportation fuels, and as such, we believe intervention is needed to deliver preferential feedstock access for the aviation sector. For example, in California, producers are driven to find the lowest-carbon solution because every

percentage that they reduce generates more carbon credits which in turn allows them to reduce costs.

Direct Incentives and Targeted Aid

The current EU State aid rules are insufficient to support the greening of aviation through SAF production. Because of the specific types of investments needed, we believe direct public support through targeted packages of incentives in the form of loan guarantees, direct subsidies and tax breaks are required at Member State or EU level.

It is the first SAF Plants which are the hardest plants to build

The US has a strategy clearly in this direction, and is becoming the most advantageous area in the world to produce SAF at present, leading by a considerable margin in terms of attracting investment to SAF upscaling. The US recognises the importance of keeping US aviation competitive and therefore is prioritising incentives over mandates. SAF in the US will almost be at cost parity with fossil kerosene, meaning that US aviation will have a significant advantage over EU based carriers in having access to a growing volume of low-cost SAF enabling customers to buy low carbon flights at an affordable price. In this sense, the US is leading the world race. Because often building the first plant is the most difficult if we look to the US example recognising the need of pre-revenue companies investing in SAF production through clear access to non-dilutive capital via federal grants and federal loan guarantees - sometimes up to 80% for first of a kind project. Similarly, the UK £180 million fund to support the construction of new SAF plants is a welcome move.

Operating Aid for Airports beyond 2024

A comment by Bastiaan de Bruijne, General Counsel, ACI EUROPE

The 2014 Guidelines on State aid to airports and airlines (or "Aviation Guidelines") introduced a regulatory framework under which operating aid to regional airports was declared compatible with the Internal Market for a transitional period of 10 years. The aid should thus be phased out by 2024 which is when regional airports were expected to reach financial viability. The European Commission has evaluated the Aviation Guidelines to decide on these rules beyond 2024.

Under the current State aid rules, airports' financial viability and therefore their eligibility for operating aid depends on their size, measured in the number of passengers per year (ppa). Airports up to 200,000 ppa are block exempted from State aid rules. The Aviation Guidelines define categories of airports up to 700,000 ppa (eligible for 80% of operating aid) and up to 3 million ppa (eligible for up to 50% of operating aid). Airports above 3 mppa should always be financially viable.

The Aviation Guidelines were evaluated as part of a Fitness Check of State aid modernisation rules – a comprehensive policy evaluation assessing whether the regulatory framework for a policy sector is "fit for purpose".[1] Essentially, the Commission noted many airports with less than 1 million passengers per year would continue to need operating aid beyond 2024.

The Airports Council (ACI EUROPE) published its own economic analysis with similar findings in 2019. Based on those findings, it recommended to increase the block exemption threshold to 1 million passengers per year. ACI also suggested that the Aviation Guidelines' thresholds and aid intensities are increased to support green airport investments – something not considered in 2014. It called for visibility on the future of the Aviation Guidelines well before their expiry in 2024.

Since then, the COVID-19 pandemic has dramatically impacted airports. The Commission pointed in the Fitness Check report to an expected recovery of air traffic by 2023 and expressed the hope that the findings would thus remain valid by 2024. The latest ACI forecasts point to a recovery only by 2025 – with a lasting impact on the financial situation of airports and a changed economic context.

ACI EUROPE has warned of a "cash-intensive and revenue weak recovery". European airports are facing a dual challenge of recovery and decarbonisation in a complete business model reset. While financial support from governments to airports has been limited, airports have exhausted cost-cutting opportunities and resorted to increasing debt by 200% compared to pre-pandemic levels. The earning capabilities of airports are affected by the slow recovery of traffic and pressure from airlines to reduce airport charges for the coming years.

Several findings of the Fitness Check must therefore be reconsidered. Whilst there is no doubt that the Aviation Guidelines must be prolonged beyond 2024, there should be a clear focus on *simplification* and *decarbonisation*.

The *simplification* of the Aviation Guidelines can be achieved by block exempting operating aid to airports with less than 1 million passengers per year. The Fitness Check report clearly points out that flexibility for these airports was needed already before the pandemic. The fact that these airports represent less than 3% of European traffic means that reviewing these cases currently puts a disproportionate burden both on the industry and the Commission when dealing with these cases.

The assumption in the Fitness Check report that airports with more than 1 million passengers are unlikely to need operating aid as they have sufficient passenger numbers must be reconsidered, as the revenue-generating capacities of airports are weakened. The finding that a business model depending on low-cost carriers is not viable is becoming even more true, but also the reality for a growing number of regional airports.

The *decarbonisation* of airports needs unequivocal support from the Commission, as European airports remain committed to reaching net zero CO_2 emissions from their operations by 2050. Airports have welcomed the draft Climate, Energy and Environmental State aid Guidelines (or "CEAAG") as a framework for green airport investments. But the Aviation Guidelines' thresholds and aid intensities still must be increased to further the decarbonisation of airports.

1 Commission Staff Working Document, 'Fitness Check of the 2012 State aid modernisation package, railways guidelines and short-term export credit insurance', SWD(2020) 257 final, 30 October 2020.

The focus of the Commission remains on the COVID-19 State aid response and the Green Agenda, whilst there is still no visibility on the revision of the Aviation Guidelines. For airports, one cannot go without the other. The final prolongation of the Temporary Framework until 30 June 2022 means the door closes for much-needed support to airports. The support for 'green recovery' investments (for example, clean fleet renewal) during a phase-out until the end of 2022 is capped at €10 million and, therefore, mainly symbolic, as airports cannot initiate such investments. The same goes for green investments when the CEAAG enter into force in 2022.

Airports need visibility on the future of the Aviation Guidelines well before 2024. A pragmatic solution would be a prolongation for five years, reflecting the time lost by the pandemic, while block exempting airports with less than 1 million passengers.

Is aid needed to restore air connectivity?

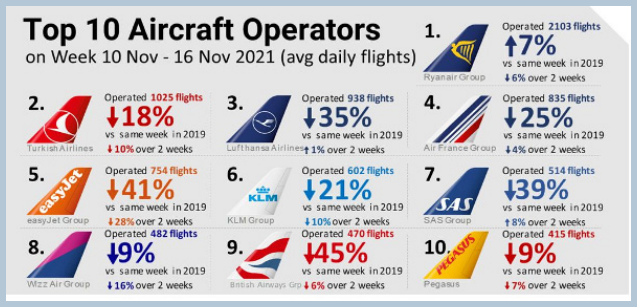
A comment by Matthew Krasa, Head of Public Affairs at Ryanair

The opinions expressed in this piece are those of the author. They do not purport to reflect the opinions or views of Ryanair.

As the aviation industry flies out of the turbulence caused by the COVID-19 crisis, many voices call for the adoption of new *ad hoc* rules to aid airlines restore connectivity.

New *ad hoc* State aid rules make sense only if new situations have arisen that the current rules are unable to address and if new rules can avoid past pitfalls. In addition, although the proponents of generous grants of aid are quick at comparing the current situation with the Apocalypse, the numbers tend to show that the end of the aviation world is not nigh.

There is no mass extinction of connections – quite to the contrary, the numbers for low fares carriers who have received no or little aid are up in the main EU and neighbouring markets. In contrast with the healthy rebound shown by low fares carriers, as of mid-November, Eurocontrol data confirms that the incumbent flag carrier airlines have not yet returned to 2019 levels of traffic.



Source: Eurocontrol

This demonstrates that the over €30bn in bailouts provided to airlines during the pandemic was not needed to ensure connectivity. This also shows that doping airlines with more State aid under new rules would probably not help connectivity either.

There is no evidence that the normal EU instruments are inadequate to address future challenges. For instance, start-up aid pursuant to the 2014 Aviation Guidelines can take care of foreseeably viable routes for which aid is needed only in a start-up phase.

To address the exceptional circumstance caused by the COVID-19 crisis, the Commission has devised the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak. The Temporary Framework provides a tailor-made solution for Member States to grant aid aimed at recovering the connectivity. In the same vein, aid to make good the damage caused by COVID-19 to airlines ensuring connectivity can also be granted under Article 107(2)(b) TFEU. While some Member States have used the above options to adopt non-discriminatory aid schemes to support airlines based on their contribution to the connectivity of a country or airport, such schemes are exceptions and the amounts involved have remained symbolic, as shown in the table below.

Member State	Instrument	Scheme	Basis	Beneficiary / Eligibility criteria
Romania	Direct grant	Romanian scheme - €1 M	Article 107(3)(b)	Airlines starting or resuming operations at Oradea airport
Denmark	Direct grant	Danish scheme - €24 M	Article 107(3)(b)	Danish airports and airlines that land in and depart from Denmark
Cyprus	Direct grant	Cypriot scheme - €6.3 M	Article 107(3)(b)	All airlines that land at/take off in Cyprus
Hungary	SI exemption	Hungarian scheme - €23.5 M	Article 107(3)(b)	Employers active in the aviation industry in Hungary
Slovenia	Direct grant	Slovenian scheme - €5 M	Article 107(3)(b)	All airlines operating routes to/ from Slovenia

Although the Temporary Framework refers repeatedly to the need to take into account the green transformation, including the EU objective of climate neutrality by 2050, in effect, it has practically never been used to support low fares airlines. It is notable that low fares airlines have the lowest per passenger / km emissions amongst EU airlines, and they provide connectivity via direct point-to-point flights. By contrast, legacy airlines often use a hub-and-spoke network architecture which leads to the multiplication of fuel-intensive takeoffs and more distance travelled through multi-flight journeys, and therefore higher emissions. Despite repeated policy references in the Temporary Framework to the green transformation and climate neutrality by 2050, the truth is that the Temporary Framework and Article 107(2)(b) TFEU have largely been used to grant individual aid to inefficient and polluting airlines.

The most recent amendment of the Temporary Framework shows timid signs of a tentative effort at remedying the easy access to subsidies for national champions that has been granted so far under this Temporary Framework. Thus, following an amendment of the Temporary Framework of November 2021, aid for solvency support should be granted on the basis of a scheme (as opposed to individual measures). In addition, it should take the form of aid for investment to invest in final beneficiaries. Such investment should be made via financial intermediaries selected in an open, transparent, and non-discriminatory procedure. If the same requirements for schemes operating on the basis of the principle of non-discrimination could apply to aid to airlines under the Temporary Framework and also under Article 107(2)(b) TFEU, then reforming the Temporary Framework might make sense.

Under these foreseeable circumstances, reducing airport charges and aviation taxes could offer a solution. Such measures would provide a boost to connectivity, support each airline in proportion to its contribution to connectivity and avoid the political jockeying involved in obtaining individual State aid.

As a final point, it should be noted that “restoring connectivity” does not simply mean restoring the exact same route network in the EU as in 2019. Specifically, many indirect connections via large EU hub airports could instead be served by more environmentally efficient sustainable direct connections. This would offer European passengers connectivity, while saving them time and money, and be consistent with the EU’s goal to reduce emissions.

New remedies in airline mergers: a distribution perspective

A comment by Emmanuel Mounier, Secretary General of eu travel tech

The COVID-19 crisis is likely to accelerate a longstanding consolidation trend in the European Aviation sector.

Competition in the European Aviation sector has been negatively impacted by a worrisome consolidation trend in recent years. Five airlines now have more than 50% of the market. These airlines have become dominant in certain markets, as acknowledged by the European Commission when assessing State aid granted to several airlines, thereby representing a serious challenge to consumer choice and market access for small airlines.

The COVID-19 pandemic has subjected the sector to a tremendous shock. Most airlines would not have survived without public support, and such support is justified. However, public money has been unevenly spread in Europe. Big carriers, which are already dominant on their markets, originating from Member States or extra-EU countries with greater ability to support their champions, have received massive support,[2] whereas other states have not been able to support "their" airlines.

It is likely that such State aid will lead to market distortions and further consolidation. Smaller airlines may be forced out of markets or be acquired by larger and wealthier airlines, as already shown by the potential IAG/Air Europa merger project.

With further consolidation on the way, further competition concerns will arise. As acknowledged in the Aviation Round Table report, "[c]*onsolidation may bring benefits to the economy, through increased efficiencies or additional investment capacity, but it may also have a negative impact on competition and prices, usually by creating or strengthening a dominant player*".[3]

To "fix" competition issues arising from airline mergers, the European Commission has so far used only a limited set of remedies, slot divestitures being the most common. However, these remedies only consider horizontal competition between airlines, disregarding competition downstream at the distribution level. They are unable to ensure that new entrants (buying the slots from the merging incumbent) will be able to successfully penetrate the market[4]. Customers regularly using the incumbent's online platform may have little exposure to the new entrant's alternative offering.

Presently, European competition authorities are primarily concerned with the number of competitors present on a given route when designing remedies. This approach does not give due consideration to the number of seats likely to be sold by these competitors, and ultimately the profitability of operating on a given route. A more holistic approach, considering the ecosystem as a whole, is required.

Indirect distribution channels are a competition-enabler in the aviation sector.

Air ticket distribution intermediaries (GDSs, TMCs, OTAs and metasearch engines) provide transparency and choice to consumers, allowing travellers to compare all available options (on price, services, environmental footprint etc.) on unbiased marketplaces. They enable not only interbrand competition (i.e., new entrants can compete directly on the merits with incumbents and attract potential new customers, lowering entry costs) but also intrabrand competition (intermediaries can compete with airlines' direct distribution channels, offering discounts and providing improved search and booking experiences). Such intrabrand competition is not fostered by slot divestiture remedies.

Distribution-related remedies are a new avenue worthy of consideration by competition authorities.

However, indirect distribution channels can only enable competition if they have non-discriminatory access to the airlines' "quality" content: i.e., their lowest fares and core ancillary services. This access is often threatened where large EU airlines have acquired dominant positions.

2 For instance, 9bn€ for LH group and 7bn€ for AirFrance/KLM.

3 Aviation Round Table Report on the Recovery of European Aviation, November 2020, page 33

4 As an example, despite slots divestitures imposed by the European Commission for the merger between Lufthansa and Sabena in 2009, no competitor has been able to operate in a viable way on the Brussels-Zurich route since then, making it a monopoly of Lufthansa Group.

Indeed, several of them have implemented abusive practices over the last decade, limiting transparency for consumers, such as: (i) surcharges on tickets purchased via GDS channels; (ii) withdrawal of basic fares from GDSs; (iii) ancillary services not made available to indirect channels; or (iv) marketing and advertising restrictions (e.g., "meta" bans and brand-bidding restrictions), making indirect distribution channels less visible on the market. These practices need to be tackled to enable indirect distribution to fully play its procompetitive function. Distribution-related remedies could achieve this.

What should distribution-related remedies look like?

These would complement slot divestitures (indicative of an issue of dominance on certain routes) with commitments by the merging entity to make "quality" content available for purchase on all consumer channels (direct or indirect) without discrimination. The risk of retaliatory effects on intermediaries can also be averted by applying this remedy at hub or market level and not just to OD pairs in relation to which slot divestitures are imposed. Indeed, if this remedy was limited to the routes covered by slot divestitures, the objective of the remedies - to ensure the competitiveness of indirect distribution marketplaces to the benefit of new entrants and consumers – could be undermined through restrictive measures applied to non-covered routes.

Indirect distribution also fosters intermodal competition.

The transparency facilitated by indirect distribution platforms can also help passengers compare different travel options, choices and prices within or across modes of transport. As highlighted by the Commission, the procompetitive effects of these platforms can be harnessed to encourage a shift to more sustainable modes of transport: "*By facilitating the access to information, booking and payment of mobility services, these services will improve the sustainability, resilience, efficiency and comfort of the transport system*"[5].

5 EC Initiative on Multimodal Digital Mobility Services, inception impact assessment roadmap

FSR Transport

The Florence School of Regulation (FSR) is a project within the European University Institute (EUI) focusing on regulatory topics. It works closely with the European Commission, and is a growing point of reference for regulatory theory and practice. It covers four areas: Communications and Media, Energy (Electricity and Gas), Transport, and Water.
The FSR-Transport Area's main activities are the European Transport Regulation Forums, which address policy and regulatory topics in different transport sectors. They bring relevant stakeholders together to analyse and reflect upon the latest developments and important regulatory issues in the European transport sector. These Forums inspire the comments gathered in this European Transport Regulation Observer. Complete information on our activities can be found online at: fsr.eui.eu

Robert Schuman Centre for Advanced Studies

The Robert Schuman Centre for Advanced Studies (RSCAS), created in 1992 and directed by Professor Erik Jones, aims to develop inter-disciplinary and comparative research on the major issues facing the process of European integration, European societies and Europe's place in 21st century global politics. The Centre is home to a large post-doctoral programme and hosts major research programmes, projects and data sets, in addition to a range of working groups and ad hoc initiatives. The research agenda is organised around a set of core themes and is continuously evolving, reflecting the changing agenda of European integration, the expanding membership of the European Union, developments in Europe's neighbourhood and the wider world.

www.eui/rsc

Published by
European University Institute (EUI)
Via dei Roccettini 9, I-50014
San Domenico di Fiesole (FI)
Italy

Co-funded by the Erasmus+ Programme of the European Union

doi:10.2870/022845
ISBN:978-92-9466-147-0
ISSN:2467-4540
QM-AX-22-008-EN-N