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Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

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II

(Non-legislative acts)

DECISIONS

COMMISSION DECISION (EU) 2015/119

of 29 July 2014

on the State aid SA.36874 (2013/C) (ex 2013/N) which Poland is planning to implement for LOT Polish Airlines SA and on the measure SA.36752 (2014/NN) (ex 2013/CP) implemented by Poland for LOT Polish Airlines SA

*(notified under document C(2014) 5429)***(Only the English text is authentic)****(Text with EEA relevance)**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof ⁽¹⁾,

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

Having regard to the decision by which the Commission decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union, in respect of the aid SA.36874 (2013/C, ex 2013/N) ⁽²⁾,

Having called on interested parties to submit their comments pursuant to the provisions cited above ⁽³⁾, and having regard to their comments,

Whereas:

I. PROCEDURE

1.1 PROCEDURE SA.36874 — NOTIFICATION OF THE RESTRUCTURING AID

- (1) By letter dated 20 June 2013, Poland notified to the Commission a restructuring aid for LOT Polish Airlines S.A. ('LOT', 'the Company') of PLN 804,29 million (approx. EUR 200 million). The notification was preceded by the granting of a rescue loan of PLN 400 million on 20 December 2012, which the Commission declared compatible on 15 May 2013 ⁽⁴⁾ subject to the commitment of Poland to communicate to the Commission a restructuring plan of LOT by 20 June 2013.

⁽¹⁾ With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union ('TFEU'). The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate. The TFEU also introduced certain changes in terminology, such as the replacement of 'Community' by 'Union' and 'common market' by 'internal market'. The terminology of the TFEU will be used throughout this Decision.

⁽²⁾ Commission Decision C(2013) 7044 final of 6 November 2013 concerning the case SA.36874 (OJ C 37, 7.2.2014, p. 55).

⁽³⁾ See footnote 2.

⁽⁴⁾ Commission Decision C(2013) 2747 final of 15 May 2013 concerning the case SA.35900 (OJ C 204, 18.7.2013, p. 4).

- (2) By letter dated 6 November 2013, the Commission informed Poland that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union ⁽⁵⁾ ('TFEU') in respect of the restructuring aid ('the opening decision'). Poland provided comments on that decision by letters dated 10 January and 12 February 2014. The Commission requested additional information by letter dated 8 May 2014, to which Poland replied on 20 May 2014.
- (3) The opening decision was published in the *Official Journal of the European Union* ⁽⁶⁾. The Commission called on interested parties to submit their comments.
- (4) The Commission received comments from seven interested parties. It transmitted them to Poland, which was given the opportunity to respond. Poland submitted observations by letter dated 28 March 2014.

1.2 PROCEDURE SA.36752 — COMPLAINT FROM RYANAIR

- (5) On 23 May 2013, the Commission received a complaint from Ryanair alleging that the Company has been granted an indefinite credit line against airport charges by the State-owned airports, to the detriment of all other airlines and constituting State aid. The Commission registered the complaint under the case number SA.36752.
- (6) The Commission forwarded the complaint with a request for information to Poland on 19 June 2013, to which Poland replied on 13 August 2013.
- (7) In accordance with recital 99 of the opening decision, the complaint is subject to the Commission's assessment within the framework of the present investigation.

1.3 LANGUAGE WAIVER

- (8) By letter dated 26 June 2014, Poland agreed to waive the right conferred upon it by Article 342 TFEU and Article 3 of Regulation No 1 ⁽⁷⁾ and to have the present decision adopted and notified in the English language.

II. DESCRIPTION

2.1 BENEFICIARY

- (9) LOT is the Polish national flag carrier established in 1929. The Company is located in the region of Mazowieckie, which is eligible for regional aid under Article 107(3)(a) TFEU. The Company is owned by the State Treasury (67,97 %), the State-owned investment fund — Towarzystwo Finansowe 'Silesia' Sp. z o.o. ('TF Silesia') (25,1 %) and LOT's own employees (6,93 %).
- (10) LOT is the parent company of the LOT Group which (as of 31 December 2013) is composed of 4 subsidiaries active in the markets of tourism (LOT Travel Sp. z o.o.), airport and handling services (GLT-LOT Usługi Lotniskowe Sp. z o.o., WRO- LOT Usługi Lotniskowe Sp. z o.o.) and aircraft maintenance (Central European Engine Services Sp. z o.o.).
- (11) In recent years, the structure of the LOT Group has changed significantly as LOT sold a number of subsidiaries in order to focus on its core business and to generate cash. In 2012 the Commission investigated and cleared from the State aid point of view the sales in 2010-2012 of three LOT's subsidiaries: LOT Services Sp. z o.o. ('LOT Services'), LOT Catering Sp. z o.o. ('LOT Catering') and LOT Aircraft Maintenance Services Sp. z o.o. ('LOT AMS') ⁽⁸⁾. Most recently, in 2012-2013 LOT sold all its shares in Petrolot Sp. z o.o. ('Petrolot'), Eurolot Sp. z o.o. ('Eurolot') and Casinos Poland Sp. z o.o. ('Casinos Poland').
- (12) As of 1 December 2013 LOT employs 1 661 people (down from 2 130 employees as of 31 October 2012) ⁽⁹⁾. Its turnover for the financial year ended 31 December 2013 was PLN 3 147 million (approx. EUR 787 million) and it is thus classified as a large enterprise.

⁽⁵⁾ OJ C 115, 9.5.2008, p. 92.

⁽⁶⁾ See footnote 2.

⁽⁷⁾ Regulation No 1 determining the languages to be used by the European Economic Community (OJ 17, 6.10.1958, p. 385).

⁽⁸⁾ Commission Decision C(2012) 8212 final of 20 November 2012 concerning the case SA.33337 (OJ C 81, 20.3.2013, p. 4).

⁽⁹⁾ In full-time equivalents.

- (13) LOT is a member of the Star Alliance and operates a fleet of 47 aircraft. Prior to the restructuring (between November 2011 and October 2012) the Company provided scheduled connections to 70 destinations in Europe, North America, Middle East and Asia, including 51 connections to European destinations, 11 connections outside Europe and 8 domestic connections.
- (14) Poland estimates that in 2012 LOT's share of the European passenger air transport business was below 1 %. As Poland's national flag carrier, LOT historically had a strong position in that Member State. In recent years, however, it has faced growing competition from low-cost carriers ('LCCs') and traditional airlines. In effect its share of the growing passenger air transport business in Poland decreased from 55 % in 2000 to 27 % in 2013. In 2012, LOT carried approximately 5 million passengers while in 2013, the first full year of the present restructuring, LOT carried approximately 4,7 million passengers.
- (15) The main competitors of LOT include Ryanair, Wizzair and Lufthansa. LOT's hub and home base is Warsaw Chopin Airport. The Company also provides international connections from 5 regional airports in Poland.
- (16) LOT's main areas of activity are the following:
- Domestic and international air transport of passengers, luggage, mail and cargo
 - Aircraft rental
 - Rendering of services related to air transport

LOT's core activity is regular passenger air transport. The most of its passengers are transported on short haul flights, which also generate the largest part of the Company's sales revenue.

- (17) In recent years LOT has experienced severe financial difficulties due mainly to inefficient operations, a deteriorating competitive environment and the global economic and financial crisis. The Company has reported losses from core activity in every financial year since 2008. Despite the gradual sales of subsidiaries and other assets (generating PLN [1 200-1 400] (*) million since 2009 ⁽¹⁰⁾) LOT has faced continuing cash flow problems which culminated in December 2012 when the Company found itself at the verge of illiquidity and was forced to ask for a rescue aid in order to avoid insolvency. Selected financial data of the Company are presented in Table 1 below.

Table 1

Selected financial data of LOT in 2010-2013 (in PLN million)

	2013	2012	2011	2010
Sales revenue	3 147,0	3 303,3	3 156,8	2 958,8
Loss from core activity	- 3,8	- 146,5	- 124,6	- 167,2
Net profit/loss	25,8	- 399,9	- 118,0	- 56,2
Inventories	216,6	198,5	230,8	252,1
Net assets	- 258,1	- 265,5	186,8	500,1
Debt ⁽¹⁾	3 223,0	2 683,2	2 016,7	1 606,9
Interest charges	123,8	87,4	81,4	60,2
Cash flows from operations	123,8	- 240,9	- 63,9	- 13,8

Source: Financial statements for the years: 2013, 2012, 2011 and 2010.

⁽¹⁾ Short-term and long-term liabilities

(*) Business secret.

⁽¹⁰⁾ Main divestments of the Company between June 2009 and April 2013.

- (18) In 2012 the Company reported a record-level net loss of PLN 400 million, significant negative cash flows from operations, increasing debt and negative equity.

2.2 THE AID MEASURE

- (19) The notified restructuring aid is to be granted by the Ministry of Treasury in the form of an equity investment. It is envisaged that the aid will consist of the conversion of the rescue loan into equity in the amount of PLN 423 million, including interest accrued until 20 June 2013 (the actual interest amount will be re-calculated as of the conversion date) and an additional increase of share capital by PLN 381,29 million. By letter dated 20 June 2013, Poland notified to the Commission the restructuring aid together with the restructuring plan, see recital 1 above. The restructuring plan provides for a restructuring period starting in the last quarter of 2012 and ending in 2015.

III. THE RESTRUCTURING PLAN

- (20) LOT identified the following major factors as the cause of its difficulties: delays in delivery and in the operations of the B787 aircraft; the global economic crisis leading to travel cost reductions by corporate and institutional customers; the increasing power of LCCs and market consolidation; disruption of prices on the domestic market caused by the short-term activity of the local low-cost competitor OLT Express; decrease of demand on the cargo market; increase in the price of aircraft fuel; fluctuations in currency exchange rates; strong bargaining power of suppliers; stricter settlement policy of credit card operators; legislative barriers limiting privatization options; lack of a long-term strategy and of a stable management; non-optimised fleet and ineffective use of resources; strong trade unions and low labour efficiency; ineffective revenue management; uncompetitive product on the long haul routes and inability to attract high-priced traffic; small share of high-margin additional revenue; ineffective sales channels; insufficient capitalization, underinvestment and lack of financial stability; ineffective risk management.
- (21) In order to address those factors, in the last quarter of 2012 LOT began implementing a restructuring plan which aims to restore long-term viability by the end of 2015.

3.1 RESTRUCTURING MEASURES

- (22) The restructuring plan provides for the implementation of a number of restructuring measures, which can be divided into the following main areas: (i) flight network and fleet modernisation; (ii) revenue management; (iii) product, distribution and additional revenue; (iv) organizational efficiency and internal optimisation; (v) optimization of external commercial relations; (vi) additional supporting initiatives. Each of these areas is described in detail below.

3.1.1 Flight network and fleet modernisation

Fleet modernisation

- (23) Fleet modernization is a cornerstone of the restructuring plan and is expected to lead to a significant reduction in operating costs. The current fleet structure of LOT is considered to be overly diversified, obsolete and costly. The most important change is the replacement of the currently used B767 aircraft by the new B787 on the long haul routes. In addition, LOT plans to restructure the remaining fleet with the aim of limiting the number of types and subtypes of airplanes and to ensure their efficient use. Fleet modernisation will not increase the number of seats offered and, therefore, the Company's capacity. The fleet inventory has been reduced from 59 aircraft in December 2012 to 47 aircraft at present and is planned to be further reduced to 38 aircraft at the end of the restructuring period.

Boeing 787

- (24) LOT has ordered eight B787 aircraft, six of which had been delivered by 30 April 2014. The delivery of the last two aircraft is planned to take place after the end of the restructuring period. Four B787 are envisaged to be used during the restructuring period while the remaining two are planned to be sub-leased at a price [...].

- (25) LOT considers the introduction of the new B787 aircraft to be a main driver for restoring viability. According to LOT, the B787 offers significant cost advantages compared to the B767 aircraft. These advantages include:
- Lower fuel consumption per block hour and per available seat kilometre ('ASK') of approximately 8-11 % which, combined with a shorter travel time, results in approximately 15 % lower fuel consumption per flight;
 - Higher cruise speed resulting in a shorter time of travel (by on average 5 % over LOT's network of long haul connections) which creates the possibility to optimise the work time of crews ⁽¹⁾;
 - Lower technical maintenance costs by about 30 %;
 - Higher efficiency of cargo transport, translating into a revenue advantage of about 15 %;
 - Standardization of the fleet, in contrast to the currently used diversified fleet of B767 which were differently configured and equipped.
- (26) It is estimated that the introduction of the B787 will improve the financial result of LOT by about PLN [135-165] million per year (from 2015 onwards) as compared to the result generated by the fleet of B767.

Boeing 737-400

- (27) The number of B737-400 aircraft was reduced from nine to three units, in accordance with the restructuring plan. The plan also envisaged that from the [...] season [...] the remaining B737-400 would be replaced by a newer generation narrow-body aircraft (B737NG or A319/A320). However, the replacement did not take place in the anticipated timeframe, as LOT subsequently agreed an extension of the lease of the remaining B737-400 for an additional [...] years, until [...]. The leasing rate would be gradually reduced from USD [...] per month/aircraft to USD [...] per month/aircraft in the final year of the agreement.

Embraer 170

- (28) The Company planned to withdraw all ten Embraer 170 ('E170') aircraft from its fleet and to replace them by the Bombardier Q400 ('DH4') aircraft. In particular, the restructuring plan provided that [...] E170 aircraft would be sold or sub-leased from the [...] season and the remaining [...] would be withdrawn as of the [...] season. The first [...] aircraft have not been sold/sub-leased so far. While the Company is still actively seeking buyers or lessees for these aircraft, it has prepared an alternative fleet scenario, which assumes their continued utilisation, in order to minimise the impact of the delayed withdrawal on financial viability. This alternative scenario will be pursued if LOT does not manage to sell or sub-lease the Embraer and/or to negotiate sufficiently low lease rates for DH4.

Embraer 175

- (29) LOT planned to withdraw [...] out of 14 Embraer 175 ('E175') aircraft from its fleet as of the 2014 winter season. Downsizing the fleet of E175 aircraft was based on the assumption that LOT would lease additional units of DH4 as a replacement for the withdrawn aircraft. As it turned out that the additional units of DH4 may not be available for lease, LOT considers utilising its full fleet of 14 E175 aircraft until the end of the restructuring period.
- (30) LOT has implemented additional fleet restructuring measures to mitigate the potential impact of the alternative fleet scenario on the financial viability. Firstly, as mentioned in recital 27 above, it reduced the operating lease rates for the three units of B737-400 which is expected to save up to USD [...] million (approx. PLN [...] million) during the extended lease period. Secondly, LOT plans to achieve additional benefits in the amount of PLN [...] million per year from the increase of efficiency of the cargo activity (in 2013 alone the cargo activity contributed to the improvement of EBIT by PLN [...] million as compared to the plan).

Flight network

- (31) The Company plans to close five connections that did not meet its profitability criteria: [...].

⁽¹⁾ E.g. reduction of travel time from New York to Warsaw to below 8 hours will make it possible to reduce the required number of pilots from 3 to 2, subject to certain other conditions being fulfilled.

- (32) LOT estimates that the closure of the unprofitable routes will improve the financial result by approximately PLN [2,2-2,6] million per year.

3.1.2 Revenue management

- (33) The restructuring measures in the area of revenue management will focus on changes to the tariff structure.
- (34) According to the restructuring plan, for flights with a load factor higher than [76-94] %, LOT plans to increase the share of higher-class passengers by [9-11] % in the class which is one tariff above the current level and by [4-6] % in the class which is two tariffs above the current level. Additionally, the tariff definition of business customers on short haul routes will be changed ⁽¹²⁾. LOT's revenue is also expected to increase through the establishment of more aggressive tariffs on selected long haul routes. The expected benefits from the implementation of this measure are estimated at PLN [...] million in 2015.
- (35) The load factor analysis in business class showed that [...] seats remained empty in 2012. The Company will therefore introduce the possibility of purchasing a paid upgrade to a higher class before the flight. This measure is expected to fill 10 % of seats that would have remained empty and will improve the financial result by about PLN [...] million in 2015.
- (36) The tariff structure under the promotion programme called 'First Minute' which is currently offered by LOT will be changed in order to eliminate excessively low prices which were charged in the past without economic justification. This should contribute to an additional growth of revenue.
- (37) The business class will be eliminated on domestic routes. This measure aims at improving the effectiveness of the seat use in an aircraft. At present 3 seats in the DH4 aircraft are reserved for business class passengers, although no extra service is offered to them. Freeing up these seats is estimated to improve the financial result by about PLN [...] million in 2015.
- (38) The internal audit of LOT revealed that, due to a weakness in the internal control system, favourable tariffs were offered in the past without justification. This practice will be prohibited. The expected benefit of this measure is estimated at PLN [...] million in 2015.
- (39) In total as a result of the revenue management measures, the Company expects to improve the result from sales by about PLN [62-76] million in 2015.

3.1.3 Product, distribution and additional revenue

- (40) The main aim of this area of restructuring is to increase revenue from additional high-margin services that are not directly linked to ticket sales. The share of additional revenue in LOT's total revenue is below the level of peer companies and much below that of LCCs. LOT has identified growth potential in this area.
- (41) Key initiatives in this group include the introduction of a 'SkyBar' (paid catering) on short haul routes, reduced on-board services for the economy class passengers and the introduction of a number of additional paid services, e.g. duty free, extra luggage, increased leg space, seat selection, priority boarding, insurance, car rental and hotel reservation.
- (42) Another target of this area of restructuring is a reduction of sales costs. The share of sales costs in the total costs of LOT amounts to [...] % and is significantly higher than in other traditional airlines analysed by the Company.
- (43) Currently, LOT generates only about [...] % of total sales through the website LOT.com. This can be compared with an average online sale at the level of 40 % among other conventional carriers and 80 % in the case of LCC's. The online sales channel has been identified as having a large potential for future growth due to its relatively low cost and high control over the sales process. The Company is going to further develop its online sales with the target estimated growth rate of online sales compared to the total sales of at least [...] % per year.

⁽¹²⁾ Until now, a different tariff was applicable to passengers if their return flight took place earlier than 3 days after departure and in the new tariff, a passenger is considered to be a business passenger if his return takes place earlier than by the first Sunday after arrival.

- (44) With reference to the network of LOT sales agents a new motivational program will be implemented, [...]. LOT will also reorganise its own domestic and foreign networks of sales offices located in airports and city centres. Considering the high cost of such activities the Company decided to reduce this distribution channel to the necessary minimum.
- (45) LOT plans to develop its potential for generating revenue in the area of marketing through, for example, offering advertising space (in the aircraft or outside of it) for third-party advertising campaigns.
- (46) The Company also plans to increase sales to corporate clients. To this end it will participate in tenders for providing travel services for large institutions and companies through the LOT Travel subsidiary (IATA agent), offering not only its own services but also the services of other airlines, sales of electronic insurance, hotel services and train tickets. In addition, the Company hopes to attract more business traffic thanks to promotion of the 'LOT for Business' program, addressed to the SME sector.
- (47) In total the restructuring measures outlined in recitals 41 to 46 are expected to improve the financial result of LOT by nearly PLN [76-94] million in 2015.

3.1.4 Organizational efficiency and internal optimization

- (48) The most important measures within this area of restructuring include (i) reduction of fuel cost, (ii) reduction of employment cost and (iii) sale of fixed assets.
- (49) Fuel cost constitutes [...] % of the Company's total cost. LOT plans to introduce a new software with the aim of optimizing the flight profile. The flight profile will be also linked to the introduction of a dynamic Cost Index, which makes it possible to choose between the minimization of fuel consumption and the realization of the scheduled flight time. The entire program is supposed to contribute an additional PLN [...] million of improvement to the financial result in 2015.
- (50) The restructuring plan provides for a reduction of employment by 833 full time equivalents ('FTEs'), i.e. by 39 % as compared to the level of employment as of 31 October 2012. The reduction is planned to affect all types of employees: ground personnel (reduction by [...] FTEs) as well as cockpit and cabin personnel (reduction by [...] FTEs). The aim of this reduction is to adapt the level of employment to the reduced flight network and fleet size as well as to increase labour efficiency. The impact of the employment reduction on the financial result of the Company in 2015 is estimated at PLN [...] million.
- (51) LOT has also changed the remuneration policy for cockpit and cabin crews (under the new regulations the salary of each pilot and cabin crew member will be strictly correlated with the actual time they spend in the air), which is expected to generate savings of up to PLN [...] million per year, and provided for additional layoffs in the administration with an estimated annual benefit of PLN [...] million. In addition, LOT has decided to centralise the procurement policy within the Company with a target to save up to PLN [...] million per year.
- (52) The Company intends to sell fixed assets (land, buildings and real estate) which are expected to generate one-off proceeds in the amount of PLN [...] million as well as annual savings of PLN [...] million.
- (53) Other measures to be implemented within this area of restructuring (e.g. reduction of cost of marketing, business trips, de-icing, training, stationery, cleaning, etc.) have a smaller financial potential.
- (54) In total, all the measures envisaged within this area of restructuring are forecasted to improve the financial result of LOT by more than PLN [156-190] million in 2015.

3.1.5 Optimization of external commercial relations

- (55) The Company plans to renegotiate its commercial contracts with all its key suppliers with the aim to reduce costs and to optimise the scope of services rendered.

- (56) First, LOT plans to renegotiate its commercial relations with 'Przedsiębiorstwo Państwowe Porty Lotnicze' (*State Enterprise Polish Airports*) ('PPL') which manages Warsaw Chopin Airport. As the official rates at Warsaw Chopin Airport are deemed to be higher than the average ⁽¹³⁾ at comparable airports, the Company intends to renegotiate airport charges taking into account the high number of operations performed by LOT at its base airport.
- (57) Secondly, LOT intends to renegotiate its commercial relations with 'Polska Agencja Żeglugi Powietrznej' (*Polish Air Navigation Services Agency*) ('the Agency'). [...]
- (58) Thirdly, LOT has indicated its intention to renegotiate the contracts with LOT AMS which provides repair and technical services. The renegotiation will concern mostly the establishment of methods for optimizing the process of servicing, repairs, and settlements.
- (59) Finally, LOT will continue negotiations with EuroLOT with the aim of [...].
- (60) As a result of the optimization of external commercial relations, the Company expects to improve financial result by over PLN [54-66] million in 2015.

3.1.6 Additional supporting initiatives

- (61) Additional supporting initiatives envisaged in the restructuring plan include, e.g. (i) change of the organisational culture and the management system; (ii) improvement of cash flow management; (iii) the implementation of a new risk management policy securing the Company against sudden fluctuations of fuel prices and (iv) improvement of the purchasing process including introduction of new IT support tools. The effects of these measures are difficult to quantify and have not been taken into account in the financial projections.

3.1.7 Summary of the restructuring measures

- (62) The expected financial impact of the implementation of all the restructuring measures envisaged in the restructuring plan in the year 2015 (the last year of the restructuring period) is summarised in the table below:

Table 2

The estimated financial impact of the restructuring measures in 2015

Restructuring area	PLN million
Flight network and fleet modernisation	[1 32,8-167,6] ⁽¹⁾
Revenue management	[62-76]
Product, distribution and additional revenue	[76-94]
Organisational efficiency and internal optimisation	[156-190]
Optimisation of external commercial relations	[54-66]
Additional supporting initiatives	—

Source: Restructuring plan.

⁽¹⁾ The implementation of the flight network and fleet modernisation measures has a positive influence on the other restructuring areas and part of its financial impact is included in the financial potential of the latter. Therefore, the impact of the flight network and fleet modernisation measures should not be aggregated with the impact of the remaining restructuring measures

⁽¹³⁾ According to the Company, Warsaw Chopin Airport charges from 2 % to 47 % higher fees (including fees for landing and possibly for take-off, environmental fees, fees for using passenger platforms, or jet bridges, fees for parking and other infrastructural fees related to the performed aviation operation) than comparable EU airports.

3.1.8 Implementation of the restructuring to date

- (63) In the past LOT had already made restructuring attempts financed from own resources (sale of subsidiaries, land, buildings, real estate and financial assets). Most recently, in 2009-2012 the Company implemented a restructuring programme which provided, among others, for a reduction of employment and fleet, other cost reduction measures, the sale of non-core assets and debt restructuring. Although it resulted in a certain improvement of LOT's financial result and cash flows, it turned out to be insufficient, particularly in reducing costs, and did not restore profitability. At the same time, the sale of assets undertaken to finance these restructuring attempts significantly limited LOT's internal sources of funding that could be used to finance the current restructuring plan.
- (64) The restructuring plan communicated to the Commission on 20 June 2013 acknowledged that the previous restructuring attempts were made in more positive market context. In 2012, the second phase of the financial crisis had an adverse effect on the airline business. In addition, there were negative tendencies concerning fuel prices and currency exchange rates. The growing market consolidation and increasing power of low-cost and non-European carriers made it even more difficult for a small traditional airline, such as LOT, to operate successfully on a stand-alone basis.
- (65) In 2013, after the first full year of implementation of the restructuring plan, the financial performance of LOT improved. Notably, it reported a net profit for the first time since 2007. Moreover, the actual financial result was much better than forecast in the restructuring plan (net profit of PLN 26 million against planned loss of PLN 196 million). Cash flows from operations increased considerably as compared to 2012, mainly thanks to better financial results.
- (66) Despite the improvement of the financial performance, the situation of LOT remained difficult. The Company still had large negative equity and generated losses from core activity (i.e. air transport). Its debt increased, mainly due to lease obligations related to the acquisition of new aircraft (envisaged in the restructuring plan).
- (67) As regards the fleet modernization, all B787 aircraft were delivered with delay. In addition, the first two aircraft had technical problems and were grounded between January and June 2013. LOT incurred extraordinary loss as it had to finance replacement aircraft. On [...], LOT signed an agreement with Boeing which provides for [...].
- (68) Furthermore, LOT continued to implement its new strategy to address the changed market context. It aims at achieving financial stability, by building long-term customer loyalty, becoming one of the most cost-efficient network carriers in Europe, restoring growth and, finally, by selling the Company to private investors.
- (69) In particular, LOT is to focus on providing direct connections from Poland to main business destinations in Europe and in the world as well as the most important Polish community centres in North America. It also wants to attract customers from Central and Eastern Europe to offer them long haul connections from the Warsaw hub. The Company is not interested in point-to-point tourist routes serviced by LCCs. LOT identified growth potential on long haul routes to/from Poland and has indicated an intention to expand on this market after the restructuring, using its new B787 aircraft which is considered to be a main pillar of the restructuring and of the new strategy.
- (70) As regards the envisaged sale of the Company to private investors, Poland amended legislation with the aim of facilitating the privatization of the Company. According to the new law, investors from the Union will be allowed to acquire a majority stake in LOT.

3.2 OVERVIEW OF THE RESTRUCTURING COSTS AND SOURCES OF FINANCING

- (71) The total restructuring costs of LOT amount to PLN [2 000-2 400] million and consist of: (i) the acquisition of five B787 aircraft — PLN [...] million; (ii) the cost of withdrawal of B737-400 and Embraer aircraft — PLN [...] million; (iii) the partial coverage of operating losses and of the financing gap — PLN [...] million; (iv) the cost of employment restructuring — PLN [...] million and (v) the repayment of the rescue loan (with interest accrued) — PLN 423 million.

- (72) The restructuring costs are planned to be covered from: (i) an own contribution amounting to PLN [1 200-1 600] million and consisting of the finance lease of five B787 aircraft and the sale of fixed assets; (ii) State aid in the amount of PLN 804 million. The own contribution accounts for [60-67] % of the restructuring costs. The restructuring costs and the sources of financing are summarised in the table below.

Table 3

Restructuring costs and sources of financing (in PLN million)

Restructuring costs	[2 000-2 400]
Acquisition of five B787 aircraft	[...]
Withdrawal of B737-400 and Embraer aircraft	[...]
Partial coverage of operating losses and financing gap	[...]
Employment restructuring	[...]
Repayment of rescue loan (with interest accrued)	423
Sources of financing	[2 000-2 400]
Finance lease of five B787 aircraft	[...]
Sale of fixed assets	[...]
Total own contribution	[1 200-1 600]
State aid	804
<i>Source:</i> Restructuring plan	

Restructuring costs

- (73) LOT has signed a contract with Boeing to acquire a total of eight B787 aircraft. According to the restructuring plan, the expenditure incurred by the Company in relation to the purchase of the first five units in the amount of PLN [...] million is considered as a restructuring cost.
- (74) As part of the fleet modernisation measures the Company plans to withdraw six B737-400, [...] E170 and [...] E175 aircraft. It will bear the cost of lease obligations and maintenance during the withdrawal period before the aircraft is returned, sold or sub-leased. The total cost of withdrawal is estimated at PLN [...] million.
- (75) At the beginning of the restructuring period the Company is expected to generate losses and negative cash flows. In order to cover these losses and maintain liquidity it will need an estimated PLN [...] million.
- (76) The restructuring plan provides for a reduction of employment by 833 FTEs. LOT estimates that the total cost of employment reduction will amount to approximately PLN [...] million and will consist of the following components: (i) a voluntary redundancy programme (PLN [...] million); (ii) the collective redundancy process (PLN [...] million); (iii) allowances for employees based abroad and subject to local law (PLN [...] million) and (iv) other redundancies, e.g. early retirement (PLN [...] million).

Sources of financing

- (77) In the autumn of 2012 the Company obtained a finance lease from the US commercial bank [...] for the acquisition of five B787 aircraft, which it notified as a source of an own contribution. LOT chose the offer of [...] out of 24 commercial offers obtained from the market. The choice was made on the basis of an analysis of the net present value and weighted average interest rate.
- (78) The period of repayment of the lease is 12 years from the date of the aircraft delivery. The Company is obliged to pay an initial fee on the aircraft delivery date and the quarterly lease payments payable in advance at the interest rate of 3-month LIBOR + [...] %, in the case of the first aircraft, and fixed rates of between [...] % and [...] %, in the case of the next four aircraft. The finance lease structure is based on a special purpose vehicle ("SPV"), a company incorporated in the United States, which serves as an intermediary between [...] and LOT ⁽¹⁴⁾.
- (79) The lease is secured by the following collateral: (i) an export guarantee from the Export Import Bank of the United States ('Ex-Im Bank') provided in accordance with the Large Aircraft Sector Understanding ('LASU') ⁽¹⁵⁾ rules; (ii) a pledge on the aircraft; (iii) the transfer of rights from insurance contracts and (iv) a pledge on the shares of the SPV.
- (80) The Ex-Im Bank guarantee is limited in duration and in amount, i.e. it concerns the purchase of five B787 in the form of a finance lease with duration of 12 years. The guarantee covers a part of the purchase price of an aircraft ([75-90] %). The rest must be covered by LOT. The provision of the guarantee by Ex-Im Bank was based on a due diligence of LOT, assessing its financial condition and the ability to service lease obligations.
- (81) The other source of own contribution, apart from the lease, is the sale of fixed assets which is expected to generate proceeds of PLN [...] million.
- (82) The State aid consists of the conversion of the rescue loan into equity in the amount of PLN 423 million and an additional equity investment of PLN 381.29 million, as described in recital 19.

3.3 RESTORATION OF LONG-TERM VIABILITY

- (83) The restructuring plan provides for the restoration of long-term viability in 2015. Financial projections covering the period 2013-2018 have been prepared under a worst-case, base-case and best-case scenario. The Company is forecast to report profit from core activity, generate positive cash flows from operations and positive return on capital employed ('ROCE') from 2014 onwards. Net profit is planned to be achieved from 2015 onwards. The table below presents selected projected financial data under the base-case scenario.

Table 4

Selected projected financial data under the base-case scenario (numbers in PLN million)

	2013	2014	2015	2016	2017	2018
Sales revenue	[2 900-3 400]	[2 900-3 400]	[2 650-3 150]	[3 300-3 800]	[4 050-4 550]	[4 300-4 800]
Profit/loss from core activity	[- 157 to - 130]	71,0	[113-137]	[200-240]	[210-250]	[175-215]
Net profit/loss	196,1	[- 20 to - 16]	[67-80]	[155-190]	[180-220]	[140-170]

⁽¹⁴⁾ A separate SPV is set up for each aircraft by Wells Fargo Delaware Trust Company, a company dealing exclusively with this type of transactions and selected by LOT. The SPV remains the owner of the aircraft and provides specialised services for all parties of the transaction.

⁽¹⁵⁾ The guidelines on aircraft financing commonly used in the airline industry until 2007 when they were replaced by the Aircraft Sector Understanding, agreed under the auspices of OECD. Since LOT initiated the acquisition of B787 aircraft before 2007 the LASU rules were still applicable.

	2013	2014	2015	2016	2017	2018
Cash flows from operations	[– 175 to – 145]	[170-206]	[300-360]	[360-440]	[370-450]	[335-415]
ROCE	[– 4,4 to – 3,6] %	[2,7-3,3] %	[5-6] %	[9-11] %	[10-12] %	[8-10] %

Source: Restructuring plan.

- (84) The financial projection is based on a number of assumptions concerning the fleet, flight network, internal organisation, operating and financial parameters, macroeconomic indicators, fuel price and the level of implementation of the restructuring measures. Major assumptions are summarised below:
- Implementation of the restructuring measures (in terms of the potential financial impact): 85 % of the potential;
 - Fuel price: USD 1,153/t in the whole projection horizon;
 - Exchange rate PLN/USD: 3.22;
 - Load factor: below [67-83] % in the winter seasons and approx. [76-94] % in the summer seasons;
 - Number of passengers carried ('000): 2012/2013 — 4 766; 2013/2014: [4 300-5 300]; 2014/2015 — [3 800-4 600]; 2015/2016 — [4 200-5 100]; 2016/2017 — [4 800-5 900]; 2017/2018 — [5 100-6 300];
 - Growth of the unit income per passenger on the scale of LOT's entire network of flight connections: on average 2,5 % *p.a.* (taking into account the effect of the increase of the number of flight operations on long-distance routes in the years 2016-2018 as well as of the growing load factor in business and premium economy class).

3.4 COMPENSATORY MEASURES

- (85) As a compensatory measure LOT proposes to close 19 connections and to reduce frequency on 5 connections ⁽¹⁶⁾. The proposed measure corresponds to a reduction of capacity by [13,5-16,5] % in terms of ASK as compared to the pre-restructuring period November 2011 — October 2012. According to LOT none of the above connections was loss-making prior to restructuring, as required by point 40 of the Community guidelines on State aid for rescuing and restructuring firms in difficulty ⁽¹⁷⁾ ('the Guidelines').
- (86) In addition, LOT plans to close 5 connections ⁽¹⁸⁾, representing a further reduction of capacity by [1,4-1,7] %, but does not consider them as compensatory measures since they were assessed by LOT as loss-making prior to restructuring.
- (87) There is no intention to increase capacity on the long haul routes in the restructuring period.
- (88) As a result of the changes introduced to LOT's network, the Company will also release a number of slots.

3.5 THE OPENING DECISION

- (89) On 6 November 2013, the Commission opened the formal investigation procedure. In the opening decision the Commission expressed doubts on the 'one time, last time' principle, restoration of long-term viability, compensatory measures and own contribution.

⁽¹⁶⁾ Connections to be closed: [...]; connections subject to a reduction of frequency: [...].

⁽¹⁷⁾ Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2.

⁽¹⁸⁾ [...].

The 'one time, last time' principle

- (90) The Commission expressed doubts whether LOT did not receive any rescue or restructuring aid in breach of the 'one time, last time' principle as a result of the deferrals of the airport charges provided to LOT by the State-owned airports ⁽¹⁹⁾. The issue was brought to the attention of the Commission in a complaint submitted by Ryanair alleging that the Company has been granted an indefinite credit line against airport charges by the State-owned airports, to the detriment of all other airlines (see Section 1.2 above).
- (91) In particular, the Commission expressed doubts concerning the argument advanced by Poland that the resources of the State-owned airports are not State resources. Furthermore, the Commission expressed doubts whether the deferrals of the airport charges granted to LOT by the State-owned airports were indeed granted on market terms, considering that the deferral periods were long, the interest was often low, and the collateral was often weak ⁽²⁰⁾. In addition, it seemed that not all of the deferred liabilities have been finally repaid.

Restoration of long-term viability

- (92) The Commission expressed skepticism that the present restructuring plan will restore LOT's viability and asked Poland to better justify this claim. It noted that LOT had previously made restructuring attempts, which failed to restore profitability, although they were conducted in an apparently better business environment.
- (93) The liquidity situation of LOT also raised concern. The Company lost liquidity in December 2012 and had been forecast to be short of cash again in August 2013 (despite receiving the rescue aid). Although this forecast did not materialise, the safety margin remained thin, as LOT had exhausted internal sources of funding, following sale of assets, and did not have access to external financing (except from the leasing) due to its difficult financial condition.
- (94) The Commission doubted that LOT's long-standing structural problems would be largely solved by the introduction of the new B787 aircraft. LOT planned to achieve approximately 30 % of total estimated financial impact of the restructuring from the operation of B787 aircraft. The Commission pointed out that the operation of such B787 aircraft would only have a direct impact on the long haul market segment (which in 2012 accounted for only [< 25] % of LOT's revenue from scheduled flights) and that there might be insufficient demand to ensure efficient utilisation of the new aircraft.
- (95) The assumption that more than 30 % of the restructuring benefits would be achieved thanks to the revenue-related measures (e.g. ancillary revenue, revenue management) seemed overestimated, given that their success depends partly on external factors, such as e.g. a change in customer behaviour. In addition, some of the planned measures (e.g. introduction of paid catering), commonly associated with LCCs, appeared to be in potential conflict with LOT's strategy to remain a traditional carrier.
- (96) LOT's assumption that result from core activity would improve from a loss of PLN [130-157] million in 2013 to a profit of PLN [64-78] million in 2014, i.e. an improvement by PLN [194-235] million within 12 months, seemed unrealistic, given its past financial record (the Company had not reported profit from core activity since 2008) and significant preliminary loss recorded in the first four months of 2013.
- (97) The Commission also questioned several assumptions underlying the financial projection contained in the restructuring plan, in particular:
- (a) relatively small deviations of key parameters (average unit revenue per passenger –by 1 %, number of passengers — by 1 %, exchange rate PLN/USD — by 10 %) from the baseline value assumed in the sensitivity analysis and fixed fuel price over a 6-year projection horizon which seemed questionable given the high volatility of prices historically;

⁽¹⁹⁾ Between 22 May 2009 and 10 April 2013, LOT concluded 23 agreements with the State-owned airports to defer payment of the airport charges for total amount of approx. PLN [285-349] million (approx. EUR [70-85] million); including: 9 agreements with Warsaw airport, 3 agreements with Gdansk, Krakow, Poznan, Katowice airports and 2 agreements with Wroclaw airport.

⁽²⁰⁾ I.e. the deferral periods were 48-396 days long; the penalty interest was in most cases below the statutory rate of the Polish law and in the case of 3 agreements no interest was charged at all; the collateral was often weak, e.g. blank promissory notes and in the case of 6 deferral agreements there was no collateral at all.

- (b) the ability of LOT to generate planned proceeds from the sub-lease of B787 and the Embraer aircraft in 2013-2018;
- (c) the achievement of 85 % of the planned restructuring benefits assumed under the base-case scenario of the financial projection.

Avoidance of undue distortions of competition (compensatory measures)

- (98) The Commission expressed reservation regarding LOT's methodology of calculating profitability of routes. According to point 40 of the Guidelines closure of loss-making activities cannot be considered as a valid compensatory measure. In view of the above reservation, the Commission did not have enough assurance that this condition was met.

Aid limited to the minimum, own contribution

- (99) The Commission expressed doubt whether the finance lease of B787 aircraft backed by the guarantee of the export credit agency ('ECA') Ex-Im Bank could be accepted as a valid source of own contribution. Taking into account that with such a strong collateral the lessor was likely to recover a full amount of debt in case of LOT's default, the lease did not seem to be a sign of markets' confidence in LOT's return to viability, as stipulated in point 43 of the Guidelines.

IV. COMMENTS FROM POLAND

- (100) Poland submitted comments and provided evidence in relation to all the issues raised in the opening decision. It concluded that the notified measure fulfils all the conditions of the Guidelines. Poland also provided an update on the implementation of the restructuring plan which demonstrates that LOT had made significant progress in the restructuring process and that its actual financial results in 2013 were much better than planned.

The 'one time, last time' principle

- (101) As regards the compliance with the 'one time, last time' principle, Poland confirmed that LOT's liabilities related to the airport charges were deferred by the State-owned airports. At the same time, Poland maintained its view that the deferrals did not constitute State aid.
- (102) According to Poland, the resources of the airports are not State resources and the decisions of the airports are not imputable to the State. However, even if the deferrals granted by the airports were to be financed by State resources, the deferrals of the airport charges fulfil the requirements of the private creditor test and therefore do not constitute State aid.
- (103) With reference to imputability, Poland confirmed that all the airports which granted deferrals to LOT are controlled directly or indirectly by the Polish State. PPL, the company managing Warsaw Airport, is wholly owned by the State Treasury. The regional airports in Gdansk, Krakow, Poznan, Katowice and Wrocław ('regional airports') are owned by PPL, regional authorities and one State-owned company.
- (104) Nonetheless, Poland reasserted the argument that the decisions taken by the airports are not imputable to the State as the ability of the State to control the airports does not justify automatically the presumption that their actions are imputable to the State. In this context Poland referred again to the *Stardust Marine* judgment ⁽²¹⁾. Poland underlined that the airports are not part of the public administration and that they run their commercial activities independently from any State interference.
- (105) In particular, Poland explained that PPL has a legal personality and operates in accordance with the Act on the State Enterprise 'Airports' of 23 October 1987 ⁽²²⁾ ('PPL Act'). According to the PPL Act, PPL's operations are carried out independently, in compliance with rational business principles and are financially autonomous. PPL does not belong to the public finance sector; it is not financed from the state budget and covers its operating costs from the revenue derived from its own economic operations. PPL's operations are controlled and supervised by the Minister in charge of transport who is entitled to change or revoke the decisions of the General Director of PPL only if they are contrary to the law. In view of Poland, the Minister has no power to interfere in the decision-making process concerning the commercial relations of PPL.

⁽²¹⁾ Case C-482/99 *French Republic v Commission (Stardust Marine)* [2002] ECR I-4397.

⁽²²⁾ Journal of Laws of 1987, no. 33, item 185 as amended.

- (106) As regards the regional airports, Poland explained that those are all private law companies ⁽²³⁾ and are subject to ordinary company law, i.e. to the Polish Code of Commercial Companies ⁽²⁴⁾ ('the Code'). They are capital companies with a separate legal personality and separate assets; acting outside of the structures of the public administration. The companies managing regional airports in Poland are managed by the shareholders' meeting, a supervisory board and the management board. Representatives of the public authorities sit at shareholders' meetings and are also members of their supervisory boards. According to the Code, the management board runs the company's day-to-day affairs and independently takes decisions on matters other than those reserved for other company bodies. Consequently, according to Poland, considering that concluding agreements on deferral of payments by the management board does not require the consent of the supervisory board or the shareholder's meeting, the decisions concerning the deferrals were independent decisions of the airports taken without any State interference.
- (107) With reference to the private creditor test, Poland brought forward several types of arguments in order to prove that the deferrals of the airport charges were concluded on market terms.
- (108) First, Poland indicated the economic context in which the airports decided to defer airport charges to LOT: a serious economic downturn of 2009 ⁽²⁵⁾ as well as other extraordinary events (the eruption of the Eyjafjallajökull volcano in April 2010). Therefore, according to Poland, when granting deferrals the airports could have assumed that the problems of LOT were of a temporary nature.
- (109) Second, Poland underlined that LOT as a key customer of the airports generated a considerable part of their revenue while the deferrals constituted only a fraction of the turnover between the airports and LOT ⁽²⁶⁾. Therefore the parties were interested in continuing their cooperation. In counterfactual scenario, LOT's insolvency would have had a negative effect on the airports' operations ⁽²⁷⁾.
- (110) Third, Poland explained that from the airports' perspective, it was better to defer part of LOT's payments than for the carrier to be put into insolvency. Notably, because at the time when the deferral decisions were made, LOT still had assets which could have been used as collateral. In comparison, in case of insolvency, the airports' receivables would have been repaid in the last category of creditors, with a much lower percentage than in case of deferral ⁽²⁸⁾. In addition, in Poland insolvency proceedings take on average 3 — 3.5 years which goes far beyond the average deferral period of approx. 6.5 months granted to LOT by the airports, see recital 114 below.
- (111) Fourth, according to Poland, the terms and conditions of the deferrals fully reflected market conditions, as regards: (i) interest rate, (ii) collateral and (iii) deferral periods.
- (112) In particular, as regards the interest rate ⁽²⁹⁾, Poland indicates that the interest rate applied in case of the deferral agreements shall be distinguished from the statutory interest ⁽³⁰⁾, which is a form of penalty for late payment while the purpose of the deferral agreements is to enable a debtor to repay the liabilities in a reasonable time.
- (113) As regards the collateral, Poland underlines that for two-thirds of the deferral agreements the deferred amount was secured by mortgages and pledges on LOT's assets. For most of the remaining deferral agreements the

⁽²³⁾ They are limited liability companies in case of the regional airports in Gdansk, Krakow and Poznan and joint-stock companies in case of the regional airports in Katowice and Wrocław.

⁽²⁴⁾ Code of Commercial Companies of 15 September 2000; consolidated text: Journal of Laws of 2013, item 1030.

⁽²⁵⁾ The crisis led to a severe fall in demand for air transport coupled with rising airlines' costs, see the Analysis of air transport market in Poland in 2009, Civil Aviation Authority 2010 and in the Performance Review Report; an Assessment of Air Traffic Management in Europe during the Calendar Year 2010, Eurocontrol 2011.

⁽²⁶⁾ In years 2009-2013, LOT generated approx. 40 % of revenue in case of Warsaw airport. The total amount of the deferrals allowed by the regional airports equated on average to 17.7 % of the turnover between the Company and these airports.

⁽²⁷⁾ This would be particularly noticeable in the case of Warsaw's Airport. As LOT is the only carrier based at Warsaw Airport, cessation of its activities there would lead to a considerable drop in the airport's turnover. This is substantiated by Poland by relevant data concerning similar scenarios which have arisen with respect to Zurich airport, Zaventem airport in Brussels and Budapest airport.

⁽²⁸⁾ The average degree, to which receivables were repaid in insolvency proceedings, at the time when the airport charge deferrals were granted, was approx. 15 % - 17.75 % according to research carried out in Poland or approx. 34 % according World Bank statistics.

⁽²⁹⁾ E.g. the interest rate imposed in the deferral agreements with Warsaw airport was [...] % p.a.

⁽³⁰⁾ At present the statutory interest is set in Poland at the level of 13 %.

deferred amount ⁽³¹⁾ was secured with blank promissory notes which accelerate the collection of debt. For only six agreements there was no collateral. In each case, however, LOT recognised its debt towards a given airport, enabling it to easily bring a claim in court, where necessary.

- (114) As regards the deferral periods, Poland underlines that the average deferral period was approx. 6.5 months which is advantageous if compared with the duration of litigation proceedings in Poland (over two years) ⁽³²⁾ or with the duration of insolvency proceedings (on average 3-3,5 years) ⁽³³⁾.
- (115) Poland also maintained that other private creditors of LOT allowed it to defer payment of debts of hundreds of millions of PLN over the similar deferral periods and at similar conditions, including an interest rate lower than the statutory interest or without interest and in some cases also without collateral ⁽³⁴⁾.
- (116) Finally, Poland confirmed that all the deferred payments have been fully repaid.
- (117) Furthermore, in order to substantiate its position as outlined in recitals 101-116 above, Poland submitted a report prepared by KPMG Advisory Spółka z ograniczoną odpowiedzialnością sp. k. ('KPMG'/'KPMG Report'). The KPMG Report describes the decision-making process of the airports which led to each of the deferral agreements. The KPMG Report provides as well for a market analysis of each of the deferral agreements. The methodology used by KPMG for the purposes of the market analysis is based on comparison of a base scenario ⁽³⁵⁾ (i.e. deferral of airport charges) with an alternative scenario ⁽³⁶⁾ (i.e. no deferral is granted to LOT). In order to verify the economic rationale of the deferral agreements, base and alternative scenarios were compared on the basis of current and net present value. The comparison of those two scenarios showed that the deferral of airport charges was, in each case, economically rational and more beneficial for the airports than the alternative scenario of initiating the insolvency proceedings.

Restoration of long-term viability

- (118) Poland argued that LOT is now in a better position to restore viability than during the previous unsuccessful restructuring attempts. First, it has received the long-awaited B787 aircraft, which is a main pillar of its restructuring plan. Secondly, LOT has addressed weaknesses of earlier attempts by focusing on previously unresolved problems (e.g. more consistent employment reduction). Thirdly, the macroeconomic environment has improved. Finally, LOT's actual financial results after five quarters of the implementation of the restructuring plan are much better than planned.

⁽³¹⁾ Constituting 26,4 % of the deferred amount.

⁽³²⁾ According to World Bank data (<http://www.doingbusiness.org>), the average time to claim receivables in Poland in years 2009-2012 was 830 days (over 2 years and 3 months), falling to 685 days in 2013.

⁽³³⁾ According to World Bank, in Poland insolvency proceedings take on average 3 years (<http://www.doingbusiness.org>). These conclusions are supported by research carried out on a sample of 94 insolvencies and published in 2009, showing that the average length of insolvency proceedings is 3.5 years (Data for: D. Baran, *Efektywność postępowań upadłościowych* [Efficiency of insolvency proceedings] [in:] E. Mączyńska (ed.), *Meandry upadłości przedsiębiorstw. Klęska czy druga szansa*, [Meanderings through company insolvency. Curse or second chance?] Warsaw 2009, p. 145).

⁽³⁴⁾ This concerns in particular hedging banks ([...]) and lessors ([...]). Some of the private creditors did not charge interest from LOT (most of the lessors, [...]). In addition, some of LOT's private creditors (e.g. [...]) also consented to defer payment of their receivables without any collateral apart from LOT's recognition of the debt.

⁽³⁵⁾ In case of the base scenario it is assumed that the deferral is granted, that the parties continue to cooperate, and that the debt is repaid in accordance with the conditions set out in the deferral agreement. It also takes into account the prospects of long-term cooperation, maintenance of the revenue base, temporary character of LOT's difficulties, and its prospects for the future, types of collateral provided by LOT and well as other conditions of the deferral agreement (interest etc.).

⁽³⁶⁾ In case of the alternative scenario it is assumed that the deferral is not granted, that the airport is initiating the insolvency proceedings, LOT ceases its activities at the airport and the airport is forced to look for other carriers to replace it. It also takes into account that the debt of the airports (as part of commercial obligations) ranks in the last category of debt to be repaid after privileged debt like: costs of insolvency proceedings, obligations towards employees, including social security and finally tax obligations (as stipulated in the Polish insolvency law). It takes also into account the average duration of insolvency proceedings (approx. 3,5 years — KPMG took into account the duration of the insolvency proceedings of the LLC Nowy Przewoźnik Sp. z o.o. carrying out its activities under the trademark Centralwings, which took more than 3,5 years — it started in May 2009 and ended in February 2013), the average amount recovered, loss of revenues and prospect to replace LOT with other carriers (taking into account three possible sub-scenarios of 3, 4 and 5 years).

- (119) LOT's liquidity situation has improved. Not only did it not lose liquidity in August 2013, as was forecast in the restructuring plan, but it gained additional sources of funding, e.g. the [...] from Boeing [...]. In effect, the actual cash flows from operations in 2013 have been better than planned.
- (120) Likewise, the actual financial impact of the introduction of B787 turned out to be better than planned. It had a positive impact not only on the long haul segment but on the entire flight network. The aircraft is not expected to solve LOT's long-standing structural problems alone, but in combination with the other restructuring measures. Traffic on the routes to be served by B787 aircraft (North America, North- and South-East Asia) is forecast to grow by 6.5 % to 10.6 % p.a. and therefore the aircraft will not be under-utilised.
- (121) In 2013 the revenue-related measures generated [> 100] % of the planned financial potential assumed in the restructuring plan. In August 2013 LOT successfully introduced paid catering and did not meet a negative customer response. According to market research, passengers are not opposed to paid services. The increase of ancillary revenue is consistent with a current market trend whereby traditional airlines move towards a hybrid business model embracing some features of LCCs and therefore should not erode LOT's brand or discourage customers.
- (122) The actual financial result for 2013 was much better than was assumed in the restructuring plan. LOT has identified potential sources of further improvement. This indicates that the forecast profit from core activity in 2014 is achievable.
- (123) Poland provided a sensitivity analysis which demonstrates that even with wider deviations of key parameters from the baseline than assumed in the restructuring plan, LOT maintains liquidity in the whole financial projection horizon 2014-2018. The fuel price, already assumed at a very conservative level (above LOT's 10-year historical maximum and 12.1 % higher than the market price at the time of notification) is unlikely to increase sharply. Concerning planned proceeds from the sub-lease of the aircraft, LOT has prepared an alternative fleet scenario providing for longer utilisation of some of the aircraft. Poland provided financial projections which demonstrate that, if this scenario is indeed implemented, LOT would still return to viability. Poland also indicated that in 2013 the Company achieved [> 100] % of the planned restructuring benefits (against 85 % assumed in the plan).

Avoidance of undue distortions of competition (compensatory measures)

- (124) Poland further clarified the way in which LOT calculates profitability of the routes (see Section 7.3.4). It emphasised that the methodology is in line with the industry standard.

Aid limited to the minimum, own contribution

- (125) Poland provided evidence demonstrating that Ex-Im Bank performed due diligence on LOT prior to agreeing to grant the guarantee and explained that in 2012 approximately 30 % of aircraft financing transactions worldwide were concluded with the participation of ECA. Poland also informed the Commission that one of the bidders offered financing to LOT without the ECA guarantee. In addition, LOT's risk was evaluated by the US capital market where in 2013 the lease was successfully refinanced by private investors.
- (126) In addition, Poland pointed out that a finance lease is an acceptable form of own contribution according to the Commission's decisional practice and reiterated that it is a typical form of financing acquisition of aircraft. According to Poland the finance lease of a new aircraft, on terms similar as those provided to LOT, see recitals 77-80 above, (including the type of collateral used), is a standard form of financing in the airline industry and has been recently used by many other European airlines, e.g. Ryanair, KLM, Norwegian Air, Czech Airlines, Austrian Airlines and Alitalia.

V. COMMENTS FROM INTERESTED PARTIES

- (127) The Commission received comments from seven interested parties: Ryanair, International Airlines Group ('IAG'), two parties who wished not to disclose their identity, the trade union 'NSZZ Solidarność 80' of the PPL ('the trade union'), the PPL itself and the business association 'Employers of Poland'.
- (128) Ryanair reiterated its allegation, originally expressed in the complaint, that LOT had already received State aid in the form of deferred airport charges granted by Polish State-owned airports. In addition, Ryanair expressed doubts on LOT's return to viability, arguing that past restructuring attempts failed, that benefits from the introduction of B787 aircraft are too optimistic and that LOT may not be able to reduce its employment costs due to possible pressure from trade unions.

- (129) According to IAG, LOT's long haul network should also be restructured. Specifically, IAG believes that there is no sufficient demand to support the capacity that LOT deploys on the US market. IAG cites the example of Malév who tried and failed to sustain direct services from Budapest to New York. In reference to the finance lease of B787 aircraft, IAG observed that the assessments by Ex-Im Bank and the commercial bank lender must have been made either in advance of the current liquidity issues or in anticipation of State aid.
- (130) The first party who wished not to disclose its identity submitted that LOT's restructuring plan is neither credible, nor achievable and will not restore LOT's long-term viability. It pointed out that the forecast ROCE is over-optimistic and observed that LOT plans to add capacity at the time when the Polish market is suffering from overcapacity. It also considered that the deferred airport charges constitute State aid. It further observed that measuring profitability of the routes proposed as compensatory measures on a variable cost-only basis is inappropriate in the long-term. According to the interested party, in the long-term all routes should be measured on what LOT refers to as a Margin 2 basis. It also expressed the view that finance lease of B787 aircraft should not be accepted as a source of own contribution as it does not demonstrate the market's confidence in LOT's return to viability.
- (131) The second interested party who wished not to disclose its identity observed that thanks to State aid LOT has increased its capacity on the Polish charter market, which has allegedly deteriorated the interested party's competitive position and violated EU State aid rules. The party also expressed doubts as to LOT's return to viability, arguing, among other things, that the benefits of the B787 are overestimated and that the financial forecasts appear unrealistic. It also questioned the profitability of the routes proposed as compensatory measures. Finally, it believes that the finance lease should not be taken into account as own contribution, as it involved practically no risk for the financing banks.
- (132) In addition, this interested party also raised the issue of the deferred airport charges ⁽³⁷⁾. It also brought to the attention of the Commission several other transactions of LOT which allegedly constituted State aid. Those transactions include:
- (a) the sale of real estate, i.e.: (i) the sale in 2011 of the LOT office building together with land at 17 Stycznia Street 43 ('Headquarters') to the State-owned company *Powszechny Zakład Ubezpieczeń S.A./PB1* ('PZU', 'PZU/PB1') for an amount of PLN [...] million (approx. EUR [...] million) and (ii) the sale in 2012 of LOT's real estate at 17 Stycznia Street 39 to the State-owned TF Silesia for an amount of PLN [...] million (approx. EUR [...] million);
 - (b) the sale of LOT subsidiaries to State-owned companies; i.e.: the sale in 2010 of LOT Services above the market price even if the company was insolvent, the sale of LOT AMS even if it was 'in a very bad financial situation', the sale in December 2012 of Petrolot, the sale in September 2012 of Eurolot, the sale in the years 2009-2010 of LOT Cargo S.A. ('LOT Cargo') and of Casinos Poland.
- (133) The trade union alleges primarily that the restructuring aid will breach the 'one time, last time' principle, as LOT had already received State aid in the form of a number of measures, most significantly, the deferred airport charges. The trade union brought to the attention of the Commission several other transactions of LOT which allegedly constituted State aid. Those transactions include:
- (a) the sale by LOT of real estate to other State-owned companies (i.e.: sale of LOT's Headquarters, sale of the real estate at 17 Stycznia Street 39, the sale of an investment real estate together with the fixed assets of the cargo terminal ('Cargo Terminal') and the sale of an investment real estate together with the fixed assets of the catering facilities ('Catering Facilities');
 - (b) the sale of LOT's subsidiaries at a price set above the market value to other State-owned companies (i.e.: the sale of LOT Services, LOT Catering Sp. z o.o. ('LOT Catering'), LOT AMS, Petrolot and Eurolot;
 - (c) the provision to LOT of loans by State-owned companies whose activities do not principally concern credit activities (i.e.: two loans provided by companies belonging to the PZU Group in December 2009 and February 2010 for a total amount of PLN [...] (approx. EUR [...]); loans provided by TF Silesia, Operator Logistyczny Paliw Płynnych Sp. z o.o. ('OLPP') and Polski Koncern Naftowy ORLEN S.A. ('PKN Orlen') for a total amount of PLN [...] (approx. EUR [...]);

⁽³⁷⁾ In particular that LOT was released from the 13 % Polish official statutory interest rate which should have been authorised by the Ministry of Transport and the Ministry of Finance.

- (d) the provision of other services: PKN Orlen and its subsidiary Petrolot allegedly supplied LOT with fuel at reduced prices.
- (134) In addition, the trade union expressed the view that the restructuring plan would not restore LOT's long-term viability and that the lease is not a sign of market's belief in return to viability.
- (135) PPL, the owner of Warsaw Chopin Airport, stated that its actions are not imputable to the State as its business decisions are taken autonomously. The agreements concluded with LOT to defer payment of airport charges were market-conform and economically most rational. PPL declared that similar agreements, albeit on a lower scale, have been concluded with other airlines and have been proposed to LCCs. LOT is a strategic partner of PPL and has significant impact on long-term development of Warsaw Chopin Airport. The potential insolvency of LOT would decrease traffic to/from Warsaw and have a negative impact on Polish economy.
- (136) The business association 'Employers of Poland' counts on the Commission to approve the restructuring aid. It believes that LOT is on track to regain viability which is confirmed by improved actual financial results. In its view, the insolvency of LOT would have a negative impact on connectivity, which in turn would adversely affect passengers, business travellers and the tourism sector.

VI. COMMENTS FROM POLAND ON THE OBSERVATIONS OF INTERESTED PARTIES

- (137) Poland addressed all of the allegations raised by the interested parties.
- (138) As regards the possible breach of the 'one time, last time' principle:
- (a) with regard to the deferred airport charges, Poland repeated its arguments concerning the lack of imputability and the fulfilment of the private creditor test;
- (b) with regard to other transactions of LOT which allegedly constitute State aid, Poland provided detailed explanations. Poland pointed out in particular that some of these transactions had already been cleared by the Commission, while others are either not imputable to the State (e.g. assets bought by private companies) or otherwise comply with the market economy investor principle. In the latter case Poland has provided evidence (e.g. independent valuations) to support its claim.
- (139) In particular, with reference to the transactions concerning real estate, Poland explained that:
- (a) The sale and leaseback of LOT's Headquarters took place on the basis of an agreement signed on 10 May 2011 between LOT and PZU/PB1. PB1 is a company indirectly wholly owned by PZU. The State holds a minority shareholding in PZU ⁽³⁸⁾. The sale price was PLN [...] (approx. EUR [...]).
- (b) The sale of real estate at 17 Stycznia Street 39 took place on the basis of an agreement signed on 31 July 2012 between LOT and TF Silesia. The State Treasury is the sole shareholder of TF Silesia. The sale price was PLN [...] (approx. EUR [...]).
- (c) The sale of the Cargo Terminal took place on the basis of an agreement signed on 25 November 2011 between LOT and LS Airport Services S.A. ('LS Airport Services'). The State Treasury is the sole shareholder of LS Airport Services. The sale price was PLN [...] (approx. EUR [...]).
- (d) The sale of the Catering Facilities took place on the basis of an agreement signed on 8 December 2011 between LOT and LOT Catering. The Regional Economic Fund ('REF'), wholly owned by the State Treasury, is the sole shareholder of LOT Catering. The sale price was PLN [...] (approx. EUR [...]).
- (140) Poland explained that with reference to the sale and leaseback transaction concerning the LOT Headquarters, LOT received 9 purchase bids, out of which PZU/PB1 offer was chosen as the most advantageous. According to Poland, the resources of companies belonging to the PZU Group are not State resources and their decisions are not imputable to the State; therefore no State aid is involved. In addition, Poland explained that the value of the real estate was subject to an independent prior valuation ⁽³⁹⁾.

⁽³⁸⁾ Powszechny Zakład Ubezpieczeń S.A. is listed on the Warsaw Stock Exchange from 12 May 2010. On the day of the transaction (i.e. 10 May 2011), the State Treasury held 35 % of its shares while the remaining 65 % were subject to free float (held mostly by the pension funds and hedge funds).

⁽³⁹⁾ The valuation by Emmerson, dated in April 2011, showed that the value of the real estate was PLN [...] (approx. EUR [...]). This value is approx. 10 % higher than the price agreed, as Emmerson assumed that the lease fee obtained by the owner would be approx. 10 % higher than that finally agreed upon and paid by LOT to PZU. For this reason there were grounds for the sale price also to be approx. 10 % lower.

- (141) Furthermore, Poland explained that in case of the sale of the real estate at 17 Stycznia Street 39, Cargo Terminal and Catering Facilities a tender procedure failed as no bids were submitted. In each case, however, the value of the real estate was subject to an independent prior valuation ⁽⁴⁰⁾.
- (142) With reference to the loan agreements, Poland explained that:
- (a) Companies belonging to PZU Group provided to LOT two loans: first in the amount of PLN [...] (approx. EUR [...]) on 14 December 2009 and second in the amount of PLN [...] (approx. EUR [...]) on 17 February 2010. The State holds a minority shareholding in PZU.
 - (b) A loan in the amount of PLN [...] (approx. EUR [...]) was provided to LOT by PKN Orlen on 28 June 2012. The State holds a minority shareholding in PKN Orlen ⁽⁴¹⁾.
 - (c) A loan in the amount of PLN [...] (approx. EUR [...]) was provided to LOT by TF Silesia on 30 March 2009. The State Treasury is the sole shareholder of TF Silesia.
 - (d) A loan in the amount of PLN [...] million (approx. EUR [...] million) was provided to LOT by OLPP on 9 March 2012. PERN Przyjaźń S.A. ('PERN'), wholly owned by the State Treasury, is the sole shareholder of OLPP.
- (143) According to Poland, the resources of companies belonging to the PZU Group and PKN Orlen are not State resources and their decision are not imputable to the State, as the State holds a minority shareholding in these companies; therefore no State aid is involved.
- (144) In case of loans which were provided by the State-owned companies (i.e. TF Silesia, OLPP), should their resources be considered as State resources and their decisions be imputable to the State, then, according to Poland, both loans were provided on market terms: the collateral provided was strong ⁽⁴²⁾ and the interest rates applied were similar to those applied by the private creditors ⁽⁴³⁾.
- (145) With reference to the sale of LOT's subsidiaries, Poland explained that:
- (a) The sale of LOT Services, LOT Catering, LOT AMS and LOT Cargo was subject to the Commission decision in case SA. 33337 ⁽⁴⁴⁾ by which the Commission concluded that all of those transactions did not involve State aid.
 - (b) 33,3 % of the shares owned by LOT in Casinos Poland were sold to Vicco Investment Sp. z o.o. ⁽⁴⁵⁾ ('Vicco') on the basis of an agreement concluded on 8 April 2013 for an amount of PLN [...] million (approx. EUR [...] million). Vicco is a private company. Therefore its resources are not State resources and its decisions are not imputable to the State. According to Poland, the value of the transaction corresponded to the market price proposed by a private tenderer, selected in an open competitive procedure.

⁽⁴⁰⁾ As regards the real estate at 17 Stycznia Street 39 the valuations were performed by: (i) a real estate appraiser, Ms. Marzena Niemczyk (permit no. 4519), from Cushman & Wakefield Poland Sp. z o.o., valuation dated 26 July 2012; (ii) Colliers International Poland Sp. z o.o., report dated 12 June 2012; and (iii) Deloitte Advisory Sp. z o.o., report dated 18 July 2012.

As regards Cargo Terminal the valuation was performed by a real estate appraiser, Ms. Marzena Niemczyk (permit no. 4519), from Cushman & Wakefield Poland Sp. z o.o., valuation dated 31 July 2011, in addition a separate report on the economic rationale of the sale of the real estate was prepared by KPMG Advisory Spółka z ograniczoną odpowiedzialnością sp. k. dated 7 November 2011.

As regards the Catering Facilities the valuation was performed by a real estate appraiser, Ms. Marzena Niemczyk (permit no. 4519), from Cushman & Wakefield Poland Sp. z o.o., valuation dated 31 July 2011, in addition a separate report on the economic rationale of the sale of the real estate were prepared by KPMG Advisory Spółka z ograniczoną odpowiedzialnością sp. k. dated 7 November 2011.

⁽⁴¹⁾ Polski Koncern Naftowy ORLEN S.A. is listed on the Warsaw Stock Exchange from 26 November 1999. On 31 December 2012, the State Treasury held 27,5 % of its shares with the remaining 72,5 % were subject to free float (held mostly by the pension and investment funds).

⁽⁴²⁾ I.e. in case of the loan provided by TF Silesia: mortgage/registered pledge on LOT's assets, assignment of rights from the insurance contract, promissory note and voluntary submission to enforcement; in case of the loan provided by OLPP: a registered pledge and voluntary submission to enforcement.

⁽⁴³⁾ I.e. in case of the loan provided by TF Silesia: WIBOR 3M + [4,5-5,5] pp. pa.; in case of the loan provided by OLPP: an interest rate of [8-10] % p.a. was applied. For comparison: the interest rate of the loan provided to LOT by PKN Orlen in the first half of 2012 was [8-10] % p.a.

⁽⁴⁴⁾ See footnote 8.

⁽⁴⁵⁾ I.e. SPV formed by Century Casinos Europe GmbH (former shareholder in Casinos Poland Sp. z o.o.). Century Casinos Europe GmbH is a private company listed on the stock exchanges in the U.S. and Austria.

- (c) 49 % of the shares owned by LOT in Petrolot were sold to PKN Orlen on the basis of an agreement concluded on 21 December 2012 for an amount of PLN [...] (approx. EUR [...]). PKN Orlen is a private company. Therefore its resources are not State resources and its decisions are not imputable to the State, as described in recital 142 above. According to Poland, the value of the transaction corresponded to the market value determined by an independent prior valuation ⁽⁴⁶⁾.
- (d) 37,90 % of the shares owned by LOT in EuroLOT were sold to TF Silesia on the basis of an agreement concluded on 27 February 2013 for an amount of [> 118] PLN (approx. EUR [> 29]). According to Poland, the sale of shares in EuroLOT took place in a competitive process through negotiations undertaken on the basis of a public invitation to negotiations ⁽⁴⁷⁾. The shares were purchased by TF Silesia, wholly owned by the State Treasury, who was the only bidder. The transaction price was based on an independent prior valuation ⁽⁴⁸⁾.
- (146) With reference to the transactions concerning the provision of fuel to LOT by PKN Orlen and its subsidiary Petrolot at reduced prices, Poland explained that PKN Orlen and Petrolot are private companies, their resources are not State resources and their decisions are not imputable to the State and therefore those transactions do not involve State aid ⁽⁴⁹⁾.
- (147) As regards other comments of the interested parties, Poland argues that LOT is in a better position to succeed now than in the past. The macroeconomic environment has improved, with the EU and Poland's economy forecast to grow faster than previously expected. Air traffic is expected to increase, particularly in Central and Eastern Europe. LOT has learnt lessons from past failed restructuring attempts and addressed previously unresolved weaknesses (e.g. it reduced employment on an unprecedented scale which brought about PLN [...] million savings in 2013). Reduction of employment has been carried out with no significant resistance from the trade unions. In addition, LOT has finally received the B787 aircraft, the lack of which was identified as one of the reasons for past difficulties. Poland has provided detailed information on the economics of operating B787 aircraft and its impact on the restructuring. In particular, based on LOT's calculations, the cost/revenue economics of the B787 aircraft is far better than for its predecessor in LOT's fleet — the B767 aircraft. During six months of operation in 2013, the B787 aircraft generated a higher financial result (by PLN [...] million) than its predecessor the B767 aircraft, in a comparable period of 2012.
- (148) Referring to the alleged insufficient demand on long haul routes, Poland submitted evidence demonstrating that it has one of the biggest and growing markets to North America, bigger than some established Western European hubs and bigger than Prague and Budapest combined. Poland argues that, contrary to the Hungarian example, LOT has a stronger base to set up a niche long haul market benefiting from substantial ethnic traffic and traffic flows from eastern markets, such as Ukraine, Belarus and Russia.
- (149) Concerning the finance lease of B787 aircraft as a source of own contribution and a sign of market confidence in LOT, Poland clarified that the commercial lenders and Ex-Im Bank carried out professional and comprehensive due diligence prior to extending financing to LOT. The assessment was made just before delivery of the aircraft in November 2012 and the creditors were fully informed about LOT's financial situation. At that time, they did not know that LOT would receive State aid, as Poland notified the rescue aid only on 14 December 2012.

⁽⁴⁶⁾ As prepared by Deloitte Advisory Sp. z o.o. on 8 May 2012. In accordance with the valuation, the market value of 49,0 % of shares in Petrolot Sp. z o.o. was estimated in the range of PLN [...] million.

⁽⁴⁷⁾ A notice on the invitation to negotiate was published on the daily 'Rzeczpospolita' on 24 July 2012, later changed with a notice in the same daily on 21 August 2012.

⁽⁴⁸⁾ The expert determined that the market value of 37,9 % of EuroLOT was in the range of PLN 118,0 to 124,0 million. The market value of 37,9 % of the equity of EuroLOT S.A. was estimated by two methods: (i) discounted cash flow method (DCF) — estimated value of PLN 124,0 million, and (ii) adjusted net asset value method — estimated value of PLN 118,0 million. Poland submitted documentary evidence prepared by Deloitte Advisory Sp. z o.o.: (i) Report on the private investor test for the purchase of shares of EuroLOT, dated 14 January 2013; (ii) Report on valuation of EuroLOT, dated 14 January 2013; (iii) Report on financial, tax and legal due diligence, dated 15 January 2013.

⁽⁴⁹⁾ In addition, Poland explained that pricing and payment terms concerning fuel are proposed by the suppliers taking into account market conditions, e.g. the declared volume of the product to be purchased. LOT, with its main base in Warsaw, is Orlen/Petrolot's biggest client on this market. Over [...] % of LOT's fuel is contracted in Poland, with the remaining part being split among other international stations. Volume discounts for big clients are an element of standard market relations between suppliers and contractors. Fuel prices in Poland remain above other stations that LOT uses even if the volume of fuel purchased abroad is much smaller.

- (150) Poland provided detailed clarifications on the methodology used by LOT to calculate profitability of the routes. Poland also recalled research data indicating that a majority of carriers have used a methodology similar to that adopted by LOT.
- (151) Concerning the restoration of long-term viability and in particular the allegedly overestimated ROCE, Poland informed the Commission that LOT conducted an analysis of ROCE among 73 worldwide airlines over the past 6 years and found that its projected ROCE is around the median of European airlines and much below the most efficient European air carriers in the last financial year. On this basis, Poland claims that the assumed ROCE should not be considered unrealistic.
- (152) Referring to the alleged market overcapacity, Poland points out that over the last three years airline capacity in Poland, measured by seats offered, has grown by 6,2 % p.a. on average, while total passenger demand has grown by 7,3 % annually. Against this background, Poland notes that in 2014 LOT will offer [...] % fewer seats from/to Poland than before the restructuring, whereas the competitors are estimated to increase their offer by over 30 %.
- (153) As regards LOT's alleged expansion on the charter market, Poland informed that LOT has actually decreased its share in this segment from [> 3] % in 2012 to [< 1,5] % in 2013 (down from [> 15] % in 2010). LOT has no plans to continue its presence in the charter market after the restructuring.

VII. ASSESSMENT OF THE AID

7.1 EXISTENCE OF STATE AID

- (154) Article 107(1) TFEU provides that any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and affects trade among Member States, is incompatible with the internal market.

7.1.1 Restructuring aid

- (155) The restructuring aid is to be granted by the Ministry of State Treasury, therefore it is clear that it involves State resources and is imputable to the State.
- (156) The restructuring aid is to be granted to one specific undertaking only, i.e. LOT, on terms that the Company would not have been able to obtain on the market, given its difficult financial condition. Poland confirms this in the restructuring plan which states that State aid is the only possible source of financing that will allow the Company to continue operations and to implement the restructuring measures. Therefore, the Commission concludes that the measure provides the beneficiary with a selective advantage.
- (157) Furthermore, the aid is apt to improve the competitive position of LOT in the air transport business. Undertakings from different Member States are competing in the air transport business in the EU, in particular since the entry into force of the third stage of liberalisation of air transport ('third package') on 1 January 1993 ⁽⁵⁰⁾. Therefore, the aid distorts or threatens to distort competition and affects trade between Member States.
- (158) On the basis of these considerations, the Commission concludes that the notified measure constitutes State aid pursuant to Article 107(1) TFEU.

7.1.2 Deferral of airport charges and other transactions

Deferral of airport charges

- (159) As regards imputability, the Commission notes that all the airports which granted deferrals to LOT are controlled either directly or indirectly by the Polish State as described in recital 103 above. Considering that in line with the settled case law ⁽⁵¹⁾ 'the mere fact that a public undertaking is under State control is not sufficient for measures taken by that undertaking (...) to be imputed to the State', the Commission has to examine, within the scope of the present investigation, the intensity of the supervision exercised by the State over the management of

⁽⁵⁰⁾ The 'third package' included three legislative measures: (i) Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers (OJ L 240, 24.8.1992, p. 1); (ii) Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes (OJ L 240, 24.8.1992, p. 8); and (iii) Council Regulation (EEC) No 2409/92 of 23 July 1992 on fares and rates for air services (OJ L 240, 24.8.1992, p. 15).

⁽⁵¹⁾ Case C-482/99 *French Republic v Commission (Stardust Marine)* [2002] ECR I-4397, par. 52.

the airports. Furthermore, the Commission has to verify whether there are any other indicators showing the involvement of the State in granting the deferrals of airport charges to LOT or whether such decisions were taken autonomously by the airports without any State interference.

- (160) The Commission notes that the KPMG Report, submitted by Poland, describes the decision-making process taken by each of the airports in case of each of the deferral agreements, including the initiation of the debt collection process, calls for payment and negotiations concerning the terms and conditions of the deferrals. The KPMG Report indicates as well the parties involved in negotiations (e.g. the legal, debt collection and finance departments of the airports). The KPMG Report does not indicate any State interference in the granting of the deferrals of the airport charges to LOT.
- (161) Nonetheless, as regards PPL, the company managing Warsaw Chopin Airport, the Commission notes that it is subject to public law and wholly owned by the State Treasury which appoints its General Director. PPL is subject to a significant level of supervision by the public authorities ⁽⁵²⁾ as described in recitals 103 and 105 above. Moreover, Warsaw airport is the main Polish airport, it handles around 10 million passengers per year and it is of capital importance for Poland's connectivity with the rest of the world. As regards the regional airports, the Commission notes that those are private law companies, directly or indirectly controlled by the State and in particular in each case PPL is one of their public shareholders ⁽⁵³⁾ as described in recital 103 above. Moreover, the operation of regional airport has an important impact on the local economy and therefore it is improbable that local authorities are not involved in some way in important operating decisions of those airports, which they control.
- (162) Taking into account the impact the decisions concerning the deferral of airport charges could have on LOT and on the activities of all those airports at local or national level and that LOT is the key customer of PPL and the strong links between PPL and the State and finally the fact that PPL is subject to public law, it is highly improbable that those decisions could have been taken without any involvement whatsoever of the State. Therefore, the Commission concludes that even if it cannot be precisely demonstrated that Poland incited PPL to defer the airport charges due by LOT, the public authorities must be considered as involved in those decisions in one way or another. In summary, the Commission concludes that there are sufficient elements to consider that the deferrals of airport charges are imputable to the State. Because the deferrals involve a potential loss of resources of public undertakings those measures are granted through States resources.
- (163) Nevertheless, in order to determine whether those measures grant an economic advantage to LOT for the purpose of Article 107(1) TFEU, the Commission must establish whether PPL and the regional airports (in deferring the airport charges) behaved in a way comparable to that of a private creditor in a similar situation. If that is the case, LOT cannot be regarded as having obtained an advantage, which it would not have obtained under normal market conditions and the measures would not therefore constitute State aid within the meaning of Article 107(1) TFEU ('the market economy operator test').
- (164) In particular, the Commission notes that in line with the settled case law ⁽⁵⁴⁾, the context in which the deferrals were granted to LOT, i.e. the economic crisis and other extraordinary events, as described in recital 108 above, should be taken into account when assessing their market conformity.
- (165) The Commission also notes that LOT is the key customer of the airports in Poland and generates a considerable part of their revenue as described in recital 109 above. Therefore, the airports have a particular interest in continuing their cooperation with LOT.
- (166) Moreover, the Commission assessed the information concerning the comparison between the advantages and disadvantages of possible options to recover the debt from LOT by the airports, i.e. deferral of the airport charges, litigation proceedings or insolvency submitted by Poland. In particular, with reference to the timeframe, the Commission notes that the average deferral period granted by the airports to LOT was of approx.

⁽⁵²⁾ The Minister in charge of transport: (i) may impose on PPL obligations if required for purposes of national defence, in case of a natural disaster, etc., (ii) may change or revoke a decision by the General Director of PPL if contrary to the law, (iii) gives its consent of the disposal of fixed assets being part of active systems securing airport traffic.

⁽⁵³⁾ In years 2009-2013, PPL held: approx. 30 % of shares in Gdansk airport, 77 % of shares in Krakow airport, approx. 45 % of shares in Poznan airport, approx. 16 % in Katowice airport and approx. 20 % in Wroclaw airport.

⁽⁵⁴⁾ Case C-482/99 *French Republic v Commission (Stardust Marine)* [2002] ECR I-4397, par. 71. ('...in order to examine whether the State has adopted the conduct of a prudent investor operating in a market economy, it is necessary to place oneself in the context of the period during which the financial support measures were taken...').

6,5 months. This seems advantageous for the airports when compared with the average time to claim receivables in Poland (i.e. over 2 years) or with the average duration of insolvency proceedings in Poland (i.e. on average 3 years). It remains advantageous also if compared with the longest deferral period granted to LOT which was of approximately 1 year. In addition, the Commission observes that when the deferral decisions were made, LOT still had assets which could have been used as collateral ⁽⁵⁵⁾. The deferrals were therefore more advantageous for the airports than filing for insolvency, where the airports' receivables would have been repaid in the last category of creditors, possibly with a much lower percentage than in case of the deferrals, as described in recitals 110 and 114 above.

- (167) As regards the terms and conditions of the deferrals, the Commission notes that the interest charged by the airports seems to reflect market conditions as it was set at a level comparable with the average interest rate ⁽⁵⁶⁾ charged for loans granted in the industry sector in the relevant period while at the same time the airports were not obliged to apply the statutory rate. Furthermore, the Commission notes that the majority of the deferred amount was secured on LOT's assets. In the remaining cases LOT provided blank promissory notes and/or LOT recognised its debt towards a given airport which significantly improved the position of airports in case of debt collection as described in recitals 112 and 113 above.
- (168) Furthermore, the Commission notes that also private creditors of LOT allowed it to defer payment of debts on similar terms and conditions, including an interest rate lower than the statutory interest or without interest and in some cases also without a collateral as described in recital 115 above.
- (169) Finally, the Commission acknowledges that all the deferred airport charges have been fully repaid by LOT as described in recital 116 above.
- (170) As regards the KPMG Report submitted by Poland, the Commission notes that it analyses the market character of each of the deferral agreements, as described in recital 117 above. In particular, the methodology used by KPMG which compares the base scenario in which the deferrals of airport charges are granted to LOT with the alternative scenario in which no deferrals of airport charges are granted to LOT and the insolvency proceedings are being initiated against LOT is based on the objectively verifiable data (statistics, concrete examples, etc.). The scenarios were compared in three different sub-scenarios which contribute to provide an objective result. In order to verify the economic rationale of the deferral agreements, base and alternative scenarios were compared on the basis of current and net present value. The comparison of those two scenarios confirms that the deferral of airport charges was, in each case, economically rational and more beneficial for the airports than the alternative scenario of initiating the insolvency proceedings. The KPMG Report is based on commonly used methods of evaluation and it does not raise doubts concerning the methodology and standards used. Based on these considerations, the Commission considers that the results of the Report provide for a reliable confirmation of the market conformity of the deferral agreements.
- (171) The Commission observes that a creditor who is considering deferring payment of its receivables cannot be compared to an investor, as the business terms and conditions in those cases are different, i.e. an investor intends to earn a profit, carefully assesses the risks, demands satisfactory security and, in the absence of security, may withdraw from the investment, etc. while a creditor is in a different situation. Its receivable already exists and is unsecured. The creditor can therefore only choose between claiming the receivable in court or resolving the matter amicably and therefore it may be willing to accept different, sometimes less advantageous terms of repayment of debt than in the case of an investor. In particular the creditor may accept certain concessions of the debtor facilitating enforcement (e.g. by recognizing the debt, voluntary submission to enforcement, etc.) or establishing security if possible. The creditor may therefore have an interest in allowing a debt deferral if it may later help for example to carry out enforcement ⁽⁵⁷⁾.
- (172) In view of these considerations, the Commission concludes that the State-owned airports acted as a market economy creditor when granting deferrals of the airport charges to LOT. Therefore, those transactions did not grant LOT any advantage that it would not have obtained under normal market conditions. It follows that the deferrals of the airport charges considered herewith do not constitute State aid.

⁽⁵⁵⁾ In particular all the deferrals granted to LOT by PPL were secured. In the majority of the cases the collateral consisted of mortgages and/or registered pledges on LOT's assets.

⁽⁵⁶⁾ Based on data of the Polish National Bank.

⁽⁵⁷⁾ Case T-198/01, *Technische Glaswerke Ilmenau GmbH v Commission* (Technische Glaswerke Ilmenau GmbH) [2004] ECR II-2717 par. 99.

Other transactions

- (173) As regards the transactions of LOT concerning real estate, in view of the clarifications provided by Poland, the Commission comes to the following conclusions.
- (174) As regards the sale of the LOT Headquarters to PZU/PB1, the Commission concludes that the purchaser is a private company, as described in recitals 139 and 140 above, and therefore its resources are not the State resources. Consequently, this transaction does not constitute State aid within the meaning of Article 107(1) TFEU.
- (175) As regards (i) the sale of real estate at 17 Stycznia Street 39 to TF Silesia, (ii) the sale of the Cargo Terminal to LS Airport Services, (iii) the sale of the Catering Facilities to LOT Catering, the Commission notes that the purchaser was a company directly or indirectly controlled by the State. In case of TF Silesia and LS Airport Services, both companies are directly controlled by the State Treasury. As regards LOT Catering, its sole shareholder REF is also wholly owned by the State Treasury, as described in recital 139 above. All those companies are private law companies subject to the Commercial Companies Code. The Code requires consent of the shareholders' meeting for the sale or purchase of real estate in case of limited liability companies, as well as, subject to certain conditions, in case of joint stock companies⁽⁵⁸⁾. Therefore, considering that the State Treasury is exercising directly or indirectly all voting rights in the shareholders' meetings of TFS, LS Airport Services and LOT Catering, the State was inevitably involved in the decision making process concerning the transactions in question. In view of these considerations, the Commission concludes that the decisions of TF Silesia, LS Airport Services and LOT Catering are imputable to the State. Since those companies are public undertakings their resources are State resources.
- (176) In all those cases, the value of the real estate was subject to an independent valuation made in accordance with generally accepted market indicators and valuation standards (including taking into account comparative transactions and local market conditions). The asset appraisers had appropriate qualifications and suitable experience. The Commission notes that the valuations were performed before the transactions took place. The Commission notes as well that the transactions in question fulfil the requirements of an independent expert valuation as stipulated in the Commission Communication on State aid elements in sales of land and buildings by public authorities⁽⁵⁹⁾. Based on these considerations, the Commission concludes that the results of those valuations are an appropriate approximation of the market prices for the above described real estates.
- (177) Therefore, the Commission concludes that the transactions concerning the sale of real estate by LOT described above did not grant LOT an advantage that it would not have obtained under normal market conditions and as a consequence they do not constitute State aid within the meaning of Article 107(1) TFEU.

Loans

- (178) As regards the loans provided to LOT, in view of the clarifications provided by Poland, the Commission comes to the following conclusions.
- (179) As regards the loans provided to LOT by PZU Group and PKN Orlen, as described in recitals 142 and 143 above, the Commission notes that those are private companies. Consequently, their decisions are not imputable to the State and their resources are not State resources. Those loans therefore do not constitute State aid within the meaning of Article 107(1) TFEU.
- (180) As regards the loan provided to LOT by TF Silesia, as already concluded in recital 175 above, the decisions of TF Silesia, are imputable to the State and its resources are State resources.
- (181) As regards the loan provided to LOT by OLPP, the Commission notes that its sole shareholder, i.e. PERN is wholly owned by the State Treasury as described in recital 142 above. Therefore, the State Treasury exercises all voting rights in the shareholders' meeting of this company and nominates all members of its management board. In view of the above, the Commission believes that the decisions of OLPP are imputable to the State and its resources are State resources.
- (182) Considering the above, with respect to the loans provided to LOT by TF Silesia and OLPP, the Commission was required to assess whether those loans were provided on market terms. Considering that in case of the loans in question, the collateral provided was strong and the interest rates applied were similar to those applied by private creditors as described in recital 144 above, the Commission concludes that those loans were provided on market terms.

⁽⁵⁸⁾ LOT Catering and TF Silesia are limited liability companies and LS Airport Services is a joint stock company.

⁽⁵⁹⁾ OJ C 209, 10.7.1997, p. 3.

- (183) Therefore, the Commission concludes that the loans provided to LOT do not constitute State aid within the meaning of Article 107(1) TFEU.

Sale of subsidiaries

- (184) As regards the sale of subsidiaries by LOT, in view of the clarifications provided by Poland, the Commission comes to the following conclusions.
- (185) As regards the sale of LOT Services, LOT Catering, LOT AMS and LOT Cargo, the Commission notes that those transactions were the object of the Commission decision in case SA 33337 ⁽⁶⁰⁾, by which the Commission concluded that those transactions did not involve State aid. That decision was not challenged and has become definitive.
- (186) As regards the interested parties' comments that LOT sold shares in those subsidiaries above their market value and in particular that the sale price of LOT AMS and LOT Services was not reflecting the fact that: (i) LOT AMS was a company in a particularly bad financial condition; and (ii) the predecessor of LOT Services, the company called LOT Ground Services Sp. z o.o. ('LOT Ground Services') was subject to insolvency proceedings as described in Recital (132) above, the Commission notes that the above transactions were already subject to the Commission investigation.
- (187) In particular, as regards LOT AMS, the sale price of the shares was based on three independent prior valuations which were described and assessed in the Commission Decision SA 33337 ⁽⁶¹⁾. Similarly, the transactions concerning LOT Cargo were also described and assessed in the Commission Decision SA 33337 ⁽⁶²⁾. As regards LOT Ground Services and LOT Services, the Commission verified whether LOT Services was a legal successor of LOT Ground Services and came to the conclusion that it only took over some of the assets of the liquidated company ⁽⁶³⁾. In view of the above, the Commission has no grounds to alter its assessment in the State aid Decision in case SA 33337.
- (188) As regards the sale of Casinos Poland to Vicco, as described in recital 145 above, the Commission notes that Vicco is a private company. Consequently, the decisions of Vicco are not imputable to the State and its resources are not State resources.
- (189) As regards the sale of Petrolot to PKN Orlen, as described in Recital (145) above, the Commission has already concluded in recital 179 above, that PKN Orlen is a private company and consequently its decisions are not imputable to the State and its resources are not State resources.
- (190) As regards the sale of Eurolot to TF Silesia, as described in recital 145 above, the Commission has already concluded that its decisions are imputable to the State and its resources are State resources. Nevertheless, the Commission also notes that the transaction was preceded by a public invitation to negotiations. Moreover, the value of the shares in Eurolot was established based on valuation reports produced before the transaction took place. The valuations were based on commonly used and accepted methodologies (i.e. discounted cash flow method (DCF) and adjusted net asset value method) and based on credible assumptions. Based on the above, the Commission concludes that the results of those valuations are an appropriate approximation of the market prices of the LOT's stake in Eurolot. In view of the above, the Commission concludes that this transaction is market conform.
- (191) Therefore, the Commission concludes that the sales of subsidiaries by LOT do not constitute State aid.

Provision of services

- (192) As regards the supply of fuel to LOT by PKN Orlen and its subsidiary Petrolot at allegedly reduced prices as described in recital 146 above, the Commission notes that PKN Orlen and its subsidiary Petrolot are private companies. Consequently, as PKN Orlen's resources are not State resources; the Commission concludes that the transactions concerning fuel supplies for LOT do not constitute State aid.

⁽⁶⁰⁾ See footnote 8.

⁽⁶¹⁾ See recitals 29-34 and 57-60 of the Commission Decision SA 33337, see footnote 8.

⁽⁶²⁾ See recitals 17-22 and 44-50 of the Commission Decision SA 33337, see footnote 8.

⁽⁶³⁾ In view of the information provided by Poland within the framework of the investigation in case SA 33337, LOT Services took over some of the assets (handling equipment) and some employees (through an external recruitment company) from the liquidated company LOT Ground Services. This was not linked with the taking over of the activities of LOT Ground Services.

7.2 LEGALITY OF THE RESTRUCTURING AID

- (193) In accordance with Article 3 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽⁶⁴⁾, aid shall not be put into effect before the Commission has taken, or is deemed to have taken, a decision authorising such aid ('standstill obligation').
- (194) To date Poland has not put into effect the restructuring aid for LOT. Therefore, the Commission concludes that the standstill obligation has been complied with.

7.3 COMPATIBILITY OF THE RESTRUCTURING AID

- (195) Article 107(3)(c) TFEU provides that State aid can be authorised where it is granted to promote the development of certain economic sectors and where this aid does not adversely affect trading conditions to an extent contrary to the common interest.
- (196) The Commission considers the present measure to constitute a restructuring aid which must be assessed in the light of the Guidelines, in order to establish whether it is compatible with the internal market pursuant to Article 107(3) TFEU.

7.3.1 Company in difficulty

- (197) According to points 12(a) and 14 of the Guidelines only firms in difficulty are eligible for restructuring aid. In order to qualify as a firm in difficulty a company must fulfil the criteria listed in point 10 or point 11 of the Guidelines.
- (198) Under point 10, a firm is considered to be in difficulty when:
- (a) in the case of a limited liability company, more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;
 - (b) whatever the type of company concerned, it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings.
- (199) In the opening decision the Commission observed that LOT, being a limited liability company, fulfilled the criteria listed in point 10(a) of the Guidelines since, as of 31 December 2012, it had lost more than half of its registered capital (169.7 %) and more than one quarter thereof over the preceding 12 months (89.3 %) ⁽⁶⁵⁾.
- (200) Due to a net profit reported in 2013, it would appear that LOT does not currently meet the second sub-criterion of point 10(a). However, the net profit achieved in 2013 was possible only thanks to the rescue aid. Without that aid there would not have been any profit in 2013 as the Company would not have remained afloat. Therefore, the Commission considers that LOT was a company in difficulty within the meaning of point 10(a) when the restructuring process started and still is.
- (201) Furthermore, in December 2012 LOT found itself at the verge of illiquidity and was forced to ask for a rescue aid in order to avoid insolvency, see recital 17 above. Poland confirmed that in the absence of the rescue aid the Company would have gone bankrupt in the short term.
- (202) Therefore, the Commission considers that LOT was a firm in difficulty as from the start of the restructuring process within the meaning of point 10(a) and (c) of the Guidelines.
- (203) Moreover, the Commission has also examined whether LOT fulfils the criteria of point 11 of the Guidelines.
- (204) Point 11 of the Guidelines provides that even when none of the circumstances set out in point 10 are present, a firm may still be considered as being in difficulty and lists some of the usual signs indicating this to be the case, such as: diminishing turnover, growing stock inventories, excess capacity, mounting debt, rising interest charges and falling or nil asset value.

⁽⁶⁴⁾ OJ L 83, 27.3.1999, p. 1.

⁽⁶⁵⁾ According to LOT's financial statements for the year 2012, the Company's registered capital on 31 December 2012 amounted to PLN 447,7 million, of which LOT lost PLN 759,8 million by 31 December 2012 of which PLN 400 million were lost in 2012 alone.

- (205) The financial statements of the Company show the following signs of a firm being in difficulty (see Table 1 above):
- Diminishing turnover: in 2013, sales revenue fell to PLN 3 147 million, the lowest level since 2010 when it reached PLN 2 958,8 million;
 - Growing stock inventories: after an initial decrease from PLN 252,1 million in 2010 to PLN 198,5 million in 2012, inventories rose to PLN 216,6 million in 2013;
 - Excess capacity: the Company has reduced employment and fleet and plans further reductions, a sign that it faces excess capacity;
 - Mounting debt: short-term and long-term liabilities increased from PLN 1 606,9 million in 2010 to PLN 3,223 million in 2013;
 - Rising interest charges: interest charges increased from PLN 60,2 million in 2010 to PLN 123,8 million in 2013;
 - Falling or nil net asset value: net assets decreased from PLN 500,1 million in 2010 to — PLN 265,5 million in 2012, and — PLN 258,1 million in 2013.

In addition, the Company has reported losses in every financial year since 2008. This tendency was reversed only in 2013 when LOT reported net profit after it had benefitted from the rescue aid. The Commission considers that a company that has reported losses of that magnitude for several years is likely to be in difficulty.

- (206) In addition, according to the auditor's opinion on the financial statements for the year 2013, there is material uncertainty as regards the ability of the Company to continue operations due to negative equity and current liabilities exceeding current assets. In earlier cases, ⁽⁶⁶⁾ the Commission concluded that, where a company has negative equity, there is an *a priori* assumption that the criteria of point 10(a) of the Guidelines are met, which would be the case for LOT since 2012. The General Court also concluded ⁽⁶⁷⁾ that a company with negative equity is a company in difficulty.
- (207) In light of the above, the Commission considers that LOT is a firm in difficulty also within the meaning of point 11 of the Guidelines.
- (208) LOT was created in 1929 (registered in its present form in 2001) and has been operating in the air passenger transport ever since, therefore it cannot be considered as a newly created firm for the purpose of point 12 of the Guidelines.
- (209) Point 13 of the Guidelines establishes that a firm belonging to or being taken over by a larger business group is not normally eligible for restructuring aid, except where it can be demonstrated that the firm's difficulties are intrinsic and are not the result of an arbitrary allocation of costs within the group, and that the difficulties are too serious to be dealt with by the group itself.
- (210) LOT is the parent company of a business group, but its difficulties are intrinsic to its activity and do not result from an arbitrary allocation of costs within the LOT Group. The factors considered to have given rise to the Company's difficulties are described in recital 20 above.
- (211) The subsidiaries of the LOT Group are too small and do not generate sufficient cash surpluses to rescue the parent company. Their combined revenue for the year 2013 accounted for only approximately 2,5 % of LOT's revenue and they recorded a combined net loss of PLN 2 million. Additionally, LOT Group itself appears to be in difficulty as it reported a consolidated net loss of PLN 164 million for the year ended 31 December 2011 (due to immateriality of the subsidiaries LOT has not been obliged to prepare consolidated financial statements since then) and accumulated losses of PLN 270 million as of that date. Therefore, the difficulties of the Company are too serious to be dealt with by the Group itself.

⁽⁶⁶⁾ Commission Decision in case C 38/2007 *Arbel Fauvet Rail*, (OJ L 238, 5.9.2008, p. 27).

⁽⁶⁷⁾ Joined Cases T-102/07 *Freistaat Sachsen v Commission* and T-120/07 *MB Immobilien and MB System v Commission*, [2010] ECR II-585, paragraphs 95 to 106.

- (212) On the basis of the above, the Commission concludes that LOT is a firm in difficulty and is eligible for restructuring aid.

7.3.2 The 'one time, last time' principle

- (213) According to point 73 of the Guidelines, if the firm concerned has already received rescue or restructuring aid in the past, including any un-notified aid, and where less than 10 years have elapsed since the rescue aid was granted or the restructuring period came to an end or implementation of the restructuring plan has been halted (whichever is the latest), the Commission will not allow further rescue or restructuring aid.
- (214) The Commission assessed, in the framework of the present investigation, whether the deferred airport charges subject to the complaint from Ryanair referred to in Section 1.2 above and further commented by other interested parties, as described in recitals 130, 132, 133 and 135 above, had an impact on compliance by Poland with the 'one time, last time' principle. Having reached the conclusion that deferred airport charges do not constitute State aid, see recital 172 above, it follows that those transactions do not have any impact on the compliance by Poland with the 'one time, last time' principle.
- (215) The same holds for the other transactions indicated by interested parties as allegedly constituting State aid, i.e. concerning: (i) the sale of real estate, (ii) the provision of loans, (iii) the sale of subsidiaries, and (iv) the provision of other services as described in recitals 132 and 133 above, as the Commission reached the conclusion that they do not constitute State aid, see recitals 177, 183, 191 and 192 above.
- (216) In view of the above, the Commission considers that neither the deferral of the airport charges nor the transactions indicated by the interested parties constitute State aid. Moreover, Poland has confirmed that the Company has not benefited from any rescue or restructuring aid in the last 10 years. The Commission therefore considers that the 'one time, last time' principle is respected.

7.3.3 Restoration of long-term viability

- (217) In order to consider a measure compatible under points 34-37 of the Guidelines, the restructuring plan must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions. The plan should enable the company to cover all its costs after restructuring and the expected return on capital must be enough to enable the restructured firm to compete on the marketplace on its own merits. The restructuring plan must describe the circumstances that led to the difficulties, thereby providing a basis for assessing whether the proposed restructuring measures are appropriate.
- (218) The restructuring plan provides for a return to long-term viability in 2015 (see Table 4). The Company is expected to generate net profits, which means that it would be in a position to cover all its costs after completing the restructuring, including depreciation and financial charges. The expected return on capital employed is forecasted to range from [5-6] % to [10-12] % in the post-restructuring period. Given that the yield on the Polish 10-year government bonds, commonly seen as an approximation of a return on a risk-free investment, is approximately 3,4 %, the expected return on capital offers a reasonably adequate risk premium and can be considered enough to enable LOT to compete in the marketplace on its own merits. On the other hand, given that the median ROCE of European airlines was 6,9 % in the last financial year (10,3 % if only profitable carriers are taken into account) and that the most efficient European carriers had ROCE of 13,4 %, the target set by LOT appears neither unrealistic nor excessive after successful restructuring.
- (219) The restructuring plan sets out in detail the circumstances that led to LOT's difficulties and provides for the measures that aim to address these difficulties which are described in detail in Chapter III above.
- (220) The Commission has reviewed the key assumptions underlying the financial projections contained in the restructuring plan and assessed the restructuring measures as well as the issues raised by the interested parties with respect to the restoration of long-term viability. As a result, it considers that LOT is in a better position to succeed now than in 2009-2012.
- (221) First, in 2013 LOT began operating the long-awaited B787 aircraft which is a key element of the new strategy and an important driver of restructuring benefits. The delay in delivery of the B787 aircraft was considered by Poland to be one of the fundamental reasons of the Company's past financial difficulties and its inability

to restore viability. LOT's new strategy is based on the use of B787 on long haul niche routes and on the effective feeding network from Poland and Central Europe built around Warsaw Chopin Airport which has been recently modernised and is expanding ⁽⁶⁸⁾.

- (222) The first actual results of the operation of B787 confirm the assumption that significant restructuring benefits will come from its introduction. In June-November 2013 profit generated by the B787 fleet was PLN [...] million higher than profit generated by its predecessor B767 in a comparable period of 2012. This was more than forecasted in the restructuring plan. Assuming that the aircraft are used for the full 12 months (unlike in 2013 when it was grounded for half of the year), the planned annual financial impact of PLN [135-165] million seems achievable. The new aircraft brought also significant savings: fuel cost was lower by [> 15] % and total direct cost was lower by [> 25] %.
- (223) Poland has also provided quantitative evidence confirming that the introduction of B787 aircraft has a positive impact not only on the long haul segment but also on the entire flight network, including short and medium haul segments which provide transfer connections for the long haul. LOT's profit from the connections served by B787 aircraft measured by Margin 2 ⁽⁶⁹⁾ (i.e. including contribution effect on the entire flight network) reached PLN [> 100] million in June-November 2013 and was higher by [> 100] % than in comparable period of 2012 when the Company used the old B767 aircraft.
- (224) Concerning the potential under-utilisation of B787 aircraft raised in the opening decision, Poland clarified that until 2013 LOT had operated five B767 aircraft on the routes from Poland to USA and Canada. At present it has six B787 aircraft which can be deployed on the same routes and an additional route to Beijing. After the restructuring period LOT plans to open new long haul routes to Asia. According to IATA transatlantic flights from Poland are expected to grow at 6,5 % p.a. in 2013-2017 and passenger traffic from Central and Eastern Europe to Asia at 9,1 %-10,6 % p.a. Poland provided data demonstrating that it has one of the biggest and growing local markets to North America, bigger than some established Western European hubs (Munich, Vienna, Copenhagen and on some routes Zurich) and bigger than the current market size of Prague and Budapest combined. This gives more assurance that the B787 aircraft can be used effectively and efficiently.
- (225) Secondly, LOT has addressed weaknesses of earlier restructuring attempts by focusing on previously unresolved problems, e.g. inconsistent employment restructuring. Already by November 2013 LOT had cut ground personnel by an unprecedented 35 % and further reductions are planned. The Company has also strengthened monitoring of the implementation of the restructuring plan.
- (226) The revenue-related measures achieved [> 100] % of their planned financial potential in 2013. In August 2013 the Company introduced paid catering which has not met negative customer response. According to LOT's market research, passengers of its economy class are not likely to oppose other paid services, apart from luggage fee (which LOT does not intend to introduce). Passengers on the Polish market, where LCCs have more than 50 % share, are used to paid services.
- (227) There seems to be a potential for growth of ancillary revenue. LOT's ancillary revenue accounts for [...] % of total revenue and is lower than the average for traditional carriers (3,1 % and increasing) and much lower than Aer Lingus (13-14 %) which LOT perceives as its strategic benchmark (due to similar size and business model). LOT has created a dedicated unit responsible for increasing ancillary revenue. As traditional airlines move towards a mixed business model combining more ancillary revenue with traditional elements of network carriers, it seems justified to consider that LOT's shift in the same direction will not erode its strategy (to remain a legacy carrier) and discourage customers.

⁽⁶⁸⁾ After the modernisation of the second passenger terminal, the capacity of the airport will grow to more than 20 million passengers, double its current size.

⁽⁶⁹⁾ For a definition of Margin 2 see recital 248.

- (228) As regards further implementation of the restructuring plan, by 31 December 2013 LOT has already realised 69 % of the planned improvement in 2014. To achieve the target set for the year ended 31 December 2014 (profit from core activity of PLN 71 million) LOT still must improve financial performance by PLN 75 million, which is a realistic goal.
- (229) In particular, LOT has identified sources of this required improvement, e.g. benefits from the already implemented restructuring measures which have recurring financial impact (PLN [> 100] million in 2013); lack of one-off cost of grounding of B787 aircraft in the first half of 2013 (PLN [> 25] million); additional profit from B787 aircraft, if it is used for the full year instead of a half-year as in 2013 (PLN [> 50] million); savings on fuel cost (PLN [> 75] million). If only a fraction of these potential improvements is actually realised, LOT should achieve its financial target for 2014.
- (230) Thirdly, the macroeconomic environment, which undermined previous restructuring attempts, has improved. After recession in 2009 and 2012 the EU economy seems to be gaining ground as it is forecasted to grow by 1,6 % in 2014 and 2.0 % in 2015. Poland's economy is expected to grow by 3,2 % in 2014, i.e. faster than was forecast when the restructuring plan was prepared (2,2 %), and by 3,4 % in 2015 ⁽⁷⁰⁾. Based on historical data cited by LOT, demand for air passenger transport services has been strongly correlated with economic growth. IATA forecasts that world passenger traffic will grow by 5,4 % p.a. in 2013-2017. According to the Association of European Airlines, in the summer timetable of 2014 Central and Eastern Europe will record the largest expansion (7 % increase of flights) of all European areas. Poland accounts for roughly 25 % of the overall air traffic in Central and Eastern Europe.
- (231) As a result, in the financial year ended 31 December 2013, the first full year of the restructuring period, LOT reported net profit of PLN 26 million (against a planned loss of PLN 196 million). According to the analysis of the Company, this first profit since 2007 was largely due to implementation of the restructuring measures and not to external factors.
- (232) LOT's liquidity has also improved significantly. The actual cash flows from operations in 2013 were by PLN 285 million higher than planned. While the restructuring plan assumed that LOT would need restructuring aid in August 2013, to date it has managed without and even generated additional sources of funding, such as [...] from Boeing of USD [...] million and net proceeds from the sale and leaseback of the sixth B787 of USD [...] million ⁽⁷¹⁾. As a result, although the Company still needs the aid to survive, the liquidity margin of safety has increased, which further supports the claim for the restoration of viability.
- (233) In the opening decision, the Commission questioned some assumptions underlying the financial projections, e.g. a relatively small deviation of key parameters underlying financial projections from the baseline, (e.g.: average unit revenue per passenger (yield) — by 1 %, the number of passengers — by 1 %, exchange rate PLN/USD — by 10 %), a fixed fuel price over a 6-year projection horizon, an implementation ratio of the restructuring measures at the level of 85 %, the amount of proceeds planned to be generated from the sub-lease of the aircraft.
- (234) Poland provided an updated sensitivity analysis which assumed wider deviations of key parameters from the baseline: yield — by 4 %, number of passengers — by 3,5 %, depreciation of PLN against USD — by 55 %. According to this analysis, in all scenarios LOT is still expected to maintain viability in the whole projection horizon 2014-2018. Notwithstanding that, Poland has stressed that the baseline levels are conservative. Planned yield is justified by historical values and has been confirmed by actual results (in 2013 yield grew faster than planned). The number of passengers, already assumed at significantly decreased levels due to restructuring and compensatory measures, is lower than would be justified by comparison with peer airlines and the growth forecasts for Polish market. Finally, according to forecasts of financial institutions quoted by LOT, the exchange rate PLN/USD is predicted to stay below the level assumed in the restructuring plan until the end of forecasts' horizon, i.e. 2016.

⁽⁷⁰⁾ *European Economic Forecast Spring 2014*, http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee3_en.pdf

⁽⁷¹⁾ On [...] LOT signed an agreement with Boeing finalizing negotiations which originated from the [...] B787 aircraft [...]. The agreement provides for [...] with an estimated cash impact of USD [...] million. In addition, the terms of sale and leaseback agreement of the sixth B787 are better than the operating lease originally envisaged in the restructuring plan. The present value of incremental cash flows amounts to USD [...] million.

- (235) The baseline fuel price assumed in the restructuring plan is above LOT's 10-year historical maximum and 12,1 % above the market price at the time of notification, i.e. relatively higher than the prices that the Commission analysed in previous airline restructuring cases ⁽⁷²⁾ (e.g. the maximum fuel price analysed in the Czech Airlines case was 5 % and in the case of Air Malta 4.5 % above the contemporary market prices). LOT can currently hedge fuel price at [...] % below the baseline level until 2015, which means that it can ensure that the price would not exceed the hedged level until the end of the restructuring period. In addition, according to a sensitivity analysis, even if this very conservative baseline price increased by 15 %, LOT would still maintain liquidity in the whole financial projection horizon.
- (236) As regards the proceeds planned to be generated from the sub-lease of the aircraft, LOT has sub-leased one B787 to tour operators and is currently working on a final agreement with the lessee of the second aircraft. LOT assesses the likelihood of the deal as high. According to comments from an interested party, the B787 is a highly-marketable aircraft. Thus the assumption concerning the sub-lease of two B787 appears achievable.
- (237) LOT is still seeking buyers or lessees for [...] E170 aircraft. Nevertheless, it has prepared an alternative fleet scenario assuming continued utilisation of the aircraft, in order to ensure that viability is restored even if these attempts fail. The Commission has examined how the alternative scenario, if implemented, would affect the financial projections. It found that the total cash outflows in 2014-2018 would be by PLN [64-78] million higher than under the baseline scenario. This negative variance remains within the safety margin provided for in the restructuring plan. Even under the worst-case scenario LOT was expected to generate accumulated cash flows of PLN [> 150] million in 2014-2018.
- (238) Moreover, LOT has provided for further restructuring measures (not included in the restructuring plan) to amortise potential negative effects of the alternative fleet scenario. The estimated financial impact of these additional measures amounts to PLN [> 50] million *p.a.* and by far exceeds possible financial gap of PLN [64-78] million in 2014-2018. According to the financial projections under the alternative fleet scenario, combined with additional restructuring measures, LOT's cash position is forecast to be even slightly better than was assumed in the restructuring plan.
- (239) In relation to the implementation ratio of the restructuring plan, based on the analysis above, the Commission considers the assumed implementation ratio of the restructuring measures of 85 % to be realistic. Furthermore, it notes that in 2013 LOT achieved 137 % of the planned restructuring benefits.
- (240) The Commission therefore considers that updated sensitivity analysis further demonstrates that the proposed restructuring measures are capable of restoring long-term viability of the Company.
- (241) Furthermore, the Commission notes that the duration of the restructuring plan is limited to three years and one quarter, running from the last quarter of 2012 till the end of 2015, which appears appropriate in the present case in view of the restructuring measures provided for in the plan, the schedule according to which they should be implemented and the first results of those measures. The duration is shorter than in the previously approved airline restructuring cases ⁽⁷³⁾, where the restructuring period was five years.
- (242) Finally, the Commission observes that the notified restructuring plan is dated 14 June 2013, while the restructuring process started at the end of 2012. Indeed, restructuring a firm in difficulty in general requires a plurality of measures, some of which may be adopted immediately and other that may need more time to be defined and implemented. It would be therefore counterproductive to impose that in order to be considered as part of the same restructuring process the former measures cannot be implemented as long as the latter measures are defined in all their details. Such an embargo on the implementation of measures that could be adopted promptly would increase the difficulties of the company and the need for further State aid.
- (243) Therefore, the Commission concludes that the proposed restructuring measures are capable of restoring long-term viability of the Company within a reasonable timescale and on the basis of realistic assumptions.

⁽⁷²⁾ Commission Decision C(2012) 6352 final of 19 September 2012 concerning the case SA.30908 (OJ L 92, 3.4.2013, p. 16); Commission Decision C(2012) 4198 final of 27 June 2012 concerning the case SA.33015 (OJ L 301, 30.10.2012, p. 29).

⁽⁷³⁾ See footnote 72.

7.3.4 Avoidance of undue distortions of competition (compensatory measures)

- (244) Pursuant to points 38-42 of the Guidelines, compensatory measures must be taken to ensure that the aid's adverse effects on trading conditions are mitigated as far as possible. The aid shall not unduly distort competition. This usually means a limitation of the presence which the company can enjoy on its markets at the end of the restructuring period. The compensatory measures should be in proportion to the distortive effects of the aid and, in particular, to the size and relative importance of the firm on its market or markets. The closure of loss-making activities cannot be considered as valid compensatory measures. The degree of compensatory measures must be established on a case-by-case basis and with regard to the objective of restoring the long-term viability of the firm. Moreover, according to point 7 of the Guidelines the Commission will request compensatory measures which minimise the effect on competitors.
- (245) According to point 56 of the Guidelines, the conditions for authorising aid are less stringent as regards the implementation of compensatory measures in assisted areas. To this extent the Commission notes that LOT is located in an assisted area according to Article 107(3)(a) TFEU.
- (246) The Commission notes that LOT is a relatively small company, facing competition from legacy carriers and LCCs. Its share in the overall European passenger air transport business is estimated at below 1 %. It has a relatively stronger (though weakening) position on the international routes to/from Poland with a share of the business estimated at 27 %. Therefore, the Commission considers that compensatory measures are necessary. Nevertheless, the relatively small size and limited market importance of LOT allow the Commission to consider that the distortive effects of the aid will be limited. This should also be taken into account in the assessment of the compensatory measures.
- (247) As compensatory measures LOT plans to close 19 connections and to reduce frequency on 5 connections (see details in Section 3.4). The proposed compensatory measures correspond to a reduction of capacity by [13,5 - 16,5] % in terms of ASK as compared to the pre-restructuring period November 2011 — October 2012. LOT claims that none of the connections concerned was loss-making prior to restructuring.
- (248) LOT calculates profitability of the routes using two measures: 'Margin 1' and 'Margin 2'. Margin 1 takes into account revenue and variable costs of a route, such as, e.g. sales, passenger and flight costs. Margin 2 additionally takes into account the so called 'contribution' (the financial impact of a route on the entire flight network of LOT) and indirect costs attributable to a route (e.g. operating lease, depreciation, fixed cost of the personnel, marketing and advertising). All of the routes concerned were profitable in terms of Margin 1.
- (249) It is the Commission's practice, to consider routes as profitable if they had a positive contribution margin in the year preceding their surrender ⁽⁷⁴⁾. The contribution margin (which corresponds to LOT's 'Margin 1') takes account of sales revenue and of variable costs (e.g. flight, passenger and distribution costs) attributable to each individual route. The contribution margin is the appropriate measure since it takes into account all costs which are directly linked to the route in question. Routes with a positive contribution margin not only cover the variable costs of a route, but also contribute to the fixed costs of the company.
- (250) It is a normal business practice to continue operations which cover variable costs in the short to medium term. Fixed costs in principle do not change with the volume of operations and have to be borne whether a connection is operated or not. Therefore, it is more beneficial for an airline to keep such connection, as long as it covers at least part of fixed costs, than to abandon it. This has been implicitly acknowledged by one of the interested parties who commented that measuring profitability on the variable cost-only basis is inappropriate for long-term considerations.
- (251) On the basis of the above, the Commission concludes that the routes in question constitute appropriate compensatory measures since they were not loss-making prior to the restructuring.
- (252) Concerning the allegation of the interested party that owing to State aid LOT has increased its capacity on the Polish charter market, the Commission observes first that so far LOT has only received the rescue aid which was entirely used to repay overdue liabilities and to cover a cash deficit from operating activities in the rescue period. Therefore, LOT did not have any surplus State aid available to finance the alleged expansion on the charter market. The future restructuring aid is not planned to be spent for this purpose either but exclusively to finance the restructuring measures.

⁽⁷⁴⁾ See Commission Decision SA.30908, see footnote 72, at recitals 130 and 131.

- (253) Secondly, LOT has not increased its capacity on the Polish charter market. On the contrary, LOT has reduced its presence on the growing Polish charter market from [> 3] % in 2012 to [$< 1,5$] % in 2013 (historically LOT had much stronger position with [> 15] % market share in 2010). LOT's activities on the charter market are temporary and are undertaken only with the aim to ensure efficient utilisation of its fleet, as was envisaged in the restructuring plan. LOT has no plans to continue its presence on the charter market after the expiration of the restructuring period.
- (254) Thirdly, charter activity is marginal to LOT, constituting only [< 1] % of its activity. The Guidelines require capacity reduction on the main market, i.e. in LOT's case — scheduled flight services.
- (255) In summary, the overall level of capacity reduction resulting from compensatory measures offered by LOT amounts to [13,5-16,5] % and is larger than the level the Commission accepted in the afore-mentioned airline restructuring cases, i.e. Czech Airlines and Air Malta. It is also worth noting that the actual capacity reduction recorded by LOT in 2013 was 1,6 percentage points higher than planned.
- (256) In addition, the Commission observes that LOT has cancelled a number of routes operating from the fully coordinated ⁽⁷⁵⁾ airports of Frankfurt, Munich, Dusseldorf, Vienna, Zurich, Helsinki, Paris, Nice, Rome, Amsterdam and Stockholm. As a result, slots pairs at those airports have been released, which creates new business opportunities for competing airlines to operate routes to and from these airports and to increase their presence in them.
- (257) In view of the above, the proposed compensatory measures are sufficient to ensure that the State aid's adverse effects on trading conditions are minimised. Consequently, the proposed compensatory measures comply with points 38-42 of the Guidelines.

7.3.5 Aid limited to the minimum, own contribution

- (258) According to points 43-45 of the Guidelines, the aid must be limited to the strict minimum, necessary to enable the restructuring to take place. The beneficiary is expected to make a significant contribution to the restructuring plan from its own resources, including the sale of assets not essential to the company's survival, or from external financing at market conditions. Such contribution must be real, i.e. actual, excluding all future profits such as cash flow and is a sign that the markets believe in the feasibility of the return to viability of the company. For a large enterprises, such as LOT, the share of own contribution must be at least 50 % of restructuring cost.
- (259) LOT's declared own contribution amounts to PLN [1 200-1 600] million and accounts for [60-67] % of the restructuring costs. It consists of: (i) the finance lease of the B787 in the amount of PLN [...] million and (ii) the sale of fixed assets planned to generate PLN [...] million.
- (260) The finance lease was provided by a private US bank [...] to finance the acquisition of five B787 aircraft. It is secured, amongst others, by the guarantee of the Ex-Im Bank and pledges on the aircraft.
- (261) According to the Guidelines, an own contribution can come from 'external financing on market conditions'. The present finance lease meets this requirement. First, it has been provided by a private bank. Secondly, LOT chose the offer of [...] in a competitive procedure from 24 commercial bids it received from the market. Thirdly, leasing of aircraft is a standard form of financing (including the type of collateral) in the airline industry, used also by LOT's competitors. According to information provided by Poland, in the last three years several EU airlines acquired aircraft with ECA guarantees, including Air France, British Airways, Lufthansa, Norwegian, KLM. In 2012 approximately 30 % of aircraft financing transactions worldwide were concluded with participation of ECA. Finally, the financing covers only a part of the purchase price of an aircraft ([75-90] %) while the rest must be paid by LOT.
- (262) On the other hand, the Guidelines stipulate that the own contribution '...is a sign that the markets believe in the feasibility of the return to viability'. Given the high quality of the collateral and apparently little or no default risk, the Commission expressed reservation in the opening decision whether the present lease can be regarded as a proof that markets believe in the restoration of LOT's long-term viability.

⁽⁷⁵⁾ Fully coordinated airports are defined in Article 2(g) of Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports (OJ L 14, 22.1.1993, p. 1). According to Article 3(4) of Regulation (EEC) No 95/93, these airports experience, at least during certain periods, capacity constraints.

- (263) Poland provided additional clarification and evidence to address this concern. Prior to granting the guarantee Ex-Im Bank performed due diligence and analysed LOT's financial standing and operations. It concluded that LOT had a viable business model and would be able to repay the lease in the long term.
- (264) Furthermore, the fact that 24 private companies offered different terms of financing for the same transaction indicates that, despite the high-quality collateral, they still considered that the financing of LOT involved certain risk (otherwise all bidders would have offered the same risk-free rate). A rational market creditor would assess this risk and take LOT's viability into account as it is a key factor influencing debtor's ability to repay the lease.
- (265) In addition, one of the bidders offered financing without the ECA guarantee which shows that the market was ready to offer the financing even in the absence of any ECA intervention. Based on the analysis conducted by an external consultant LOT chose the offer of [...] as more competitive.
- (266) LOT's risk was also evaluated by the US capital market where in 2013 the lease was successfully refinanced from the initial funding structure based on the mechanism of a loan to a funding structure based on the issuance of bonds. The bonds were acquired by private investors who accepted the associated risk and thus tacitly expressed their belief that the underlying lease obligations will be settled.
- (267) It is a normal market practice for lessors to minimise risk by seeking the highest-quality collateral and possibly a guarantee. The fact that [...] provided financing on the basis of the ECA guarantee is thus not a proof that the markets did not believe in LOT's viability. On the other hand, a lessor would not provide funding just because the collateral is good if he is convinced that the lessee will not be able to repay the lease. The lessor in any case runs a certain degree of credit risk given that it would suffer losses in the event of a default of the lessee (i.e. the immediate loss of income from rent, which continues until the aircraft can be re-leased to a new customer, as well the cost incurred in reconfiguring the aircraft for another operator and the cost incurred for executing the collaterals and the guarantee).
- (268) In view of the above, the finance lease can be considered as a sign that markets believed in LOT's return to viability. The Commission notes in this respect that it has already accepted a finance lease as a valid source of own contribution in the Czech Airlines and airBaltic restructuring cases ⁽⁷⁶⁾.
- (269) As regards the second source of the notified own contribution, namely the sale of fixed assets, Poland informed that proceeds in the amount of PLN [...] have been achieved thus far. In addition, Poland provided independent expert valuations confirming the market value of additional real estate in the amount of PLN [...]. The analysis of these valuations carried out by the Commission did not disclose any error. The valuations use accepted methodologies and are based on credible assumptions. Therefore, the Commission considers that the results of the valuations are an appropriate approximation for the market prices of the assets to be sold. The value of the remaining assets ⁽⁷⁷⁾ envisaged as own contribution has either not been confirmed by an independent valuation or any other reliable evidence or the valuations are not up to date. Therefore, the Commission considers an own contribution amounting to PLN 30 650 928 (i.e. the proceeds actually achieved and the planned proceeds backed by independent expert valuations) as acceptable in relation to the sale of these assets.
- (270) On the basis of these considerations, the Commission concludes that the own contribution in the amount of PLN [1 200-1,600] meets the criteria of the Guidelines. This amount accounts for [60-67] % of total restructuring cost and is well above the 50 % threshold required for large enterprises. The finance lease alone accounts for [60-67] % of total restructuring cost and thus would be sufficient to meet the required threshold.
- (271) In light of all the above, the Commission concludes that the notified measure meets the compatibility conditions of the Guidelines.

VIII. CONCLUSION

- (272) The Commission concludes that the notified measure constitutes State aid within the meaning of Article 107(1) TFEU, which is compatible with the internal market on the basis of Article 107(3)(c) TFEU read in conjunction with the Guidelines.

⁽⁷⁶⁾ See Commission Decision SA.30908, see footnote 72, at Recitals (119) and (145); Commission Decision C(2014) 4552 final of 9 July 2014 concerning the case SA.34191, not yet published, at Recital (212).

⁽⁷⁷⁾ These are: real estate located in Bledzewo k/Sierpca woj. mazowieckie; real estate in Warsaw located at ul. Płocka 47 and 2 garages located at Kraków Airport.

- (273) The Commission also concludes that the deferrals of airport charges mentioned in recital 90 and the other transactions mentioned in Recitals 132 and 133 do not constitute aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.
- (274) Finally, the Commission notes that Poland agreed to have the present decision adopted and notified in the English language,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which Poland is planning to implement for LOT Polish Airlines S.A., amounting to PLN 804.29 million, is compatible with the internal market within the meaning of Article 107(3)(c) of the Treaty.

Article 2

The following measures do not constitute State aid within the meaning of Article 107(1) TFEU.

1. The deferrals of the airport charges granted to LOT by the State-owned airports between May 2009 and April 2013;
2. The following real estate transactions:
 - (a) The sale and leaseback of LOT's Headquarters on the basis of an agreement signed on 10 May 2011 between LOT and PZU/PB1 for the sale price of PLN [...] (c. EUR [...]).
 - (b) The sale of real estate at 17 Stycznia Street 39 on the basis of an agreement signed on 31 July 2012 between LOT and TF Silesia for the sale price of PLN [...] (c. EUR [...]).
 - (c) The sale of the Cargo Terminal on the basis of an agreement signed on 25 November 2011 between LOT and LS Airport Services for the sale price of PLN [...] (c. EUR [...]).
 - (d) The sale of the Catering Facilities on the basis of an agreement signed on 8 December 2011 between LOT and LOT Catering for the sale price of PLN [...] (c. EUR [...]).
3. The following loan agreements:
 - (a) Two loans provided to LOT by the companies belonging to PZU Group: first in the amount of PLN [...] (c. EUR [...]) on 14 December 2009 and second in the amount of PLN [...] (c. EUR [...]) on 17 February 2010.
 - (b) A loan in the amount of PLN [...] (c. EUR [...]) provided to LOT by PKN Orlen on 28 June 2012.
 - (c) A loan in the amount of PLN [...] (c. EUR [...]) provided to LOT by TF Silesia on 30 March 2009.
 - (d) A loan in the amount of PLN [...] million (c. EUR [...] million) provided to LOT by OLPP on 9 March 2012.
4. The sale of the following LOT's subsidiaries:
 - (a) The sale of 33,3 % of the LOT shares in Casinos Poland to Vicco on the basis of an agreement concluded on 8 April 2013 for an amount of PLN [...] million (c. EUR [...] million).
 - (b) The sale of 49 % of the LOT shares in Petrolot to PKN Orlen on the basis of an agreement concluded on 21 December 2012 for an amount of PLN [...] (c. EUR [...]).
 - (c) The sale of 37,90 % of the LOT shares in Eurolot to TF Silesia on the basis of an agreement concluded on 27 February 2013 for an amount of [> 118 million] PLN (c. EUR [> 29 million]).
5. The transactions concerning the provision of fuel to LOT by PKN Orlen and its subsidiary Petrolot.

Article 3

This Decision is addressed to the Republic of Poland.

Done at Brussels, 29 July 2014

For the Commission
Joaquín ALMUNIA
Vice-president

COMMISSION DECISION (EU) 2015/120**of 29 October 2014****on the aid scheme SA.27317 (C 25/09) (ex N 673/08) which Italy is planning to implement for digital projection equipment***(notified under document C(2014) 7888)***(Only the Italian text is authentic)****(Text with EEA relevance)**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

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

Having called on interested parties to submit their comments pursuant to the provisions cited above ⁽¹⁾ and having regard to their comments,

Whereas:

I. PROCEDURE

- (1) On 30 December 2008 Italy notified the Commission of its intention to introduce tax incentives for film investment, film distribution and digital cinema. The Italian authorities submitted additional information on 2 April 2009 and 23 June 2009.
- (2) By letter dated 22 July 2009, the Commission informed Italy that it had decided to approve Italy's film investment and distribution tax incentives. At the same time, the Commission informed Italy that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union in respect of the proposed tax credit for investment in digital projection equipment.
- (3) The Commission's decision to initiate the procedure was published in the *Official Journal of the European Union* ⁽²⁾. The Commission called on interested parties to submit their comments.
- (4) A workshop on the subject was held jointly by the Italian Ministry of Culture and Tourism and the European Commission in Rome on 21 October 2009.
- (5) The Commission received comments from interested parties. It forwarded them to Italy, which was given the opportunity to react; the Italian authorities' observations were received on 19 January 2010. Further exchanges of information took place after that, including additional letters from the Italian authorities received on 7 September 2010, 12 April 2011, 1 June 2011, 1 December 2011, 10 May 2012, 14 September 2012, 23 April 2013, 6 December 2013, 18 April 2014, 11 June 2014 and 1 August 2014.

II. DESCRIPTION OF THE MEASURE**1. The notified measure**

- (6) The tax credit for exhibitors installing digital projection equipment was part of a set of tax measures for the film sector introduced by the Italian authorities. Together, these tax measures were intended to stimulate the market dynamics to support Italian cultural films in an environment conducive to competition and to promote such films in Italy and Europe.
- (7) The digital cinema tax credit scheme offers a 30 % tax credit for the costs of introducing digital projection equipment. The maximum annual tax credit is capped at EUR 50 000 per screen.

⁽¹⁾ OJ C 196, 20.8.2009, p. 9.

⁽²⁾ Cf. footnote 1.

- (8) The following costs may be eligible:
- (a) the purchase of digital projection and reproduction equipment;
 - (b) the purchase of equipment and machinery for receiving digital signals via terrestrial and/or satellite transmission;
 - (c) the purchase via financial lease or the rental of the equipment, systems and machinery referred to in the above points; the relevant contracts must include an obligation to purchase the assets on expiry of the lease, or a provision for the advance exercise of this option by the user company;
 - (d) expenditure on staff training activities;
 - (e) associated and ancillary expenditure for renovating and adapting projection booths, equipment and utilities and ancillary premises formerly used for 35 mm film projection.

The expenditure under the latter two points cannot constitute more than 20 % of the total expenditure incurred for points (a), (b) and (c).

- (9) According to the original notification of the Italian authorities, support would be unconditional for cinemas with between 1 and 4 screens and for multiplex cinemas with between 5 and 10 screens in towns with a population of 50 000 or less. For other multiplexes up to 24 screens, there would be an obligation to show cultural films for 50 % of the screenings and to convert at least 50 % of the screens to digital projection as a condition of the aid.
- (10) The tax credit applies to film companies which are liable for taxation in Italy.
- (11) The legal bases for the scheme are the following:
- (a) Law No 244 of 24 December 2007 laying down provisions for drawing up the annual and multiannual state budget (*legge 24.12.2007 n.244*);
 - (b) Decree-Law No 91 of 8 August 2013, converted, with amendments, into Law No 112 of 7 October 2013 (*decreto legge 8.8.2013, n.91, convertito, con modificazioni, dalla legge 7 ottobre 2013, n.112*);
 - (c) new provisions implementing the tax credits granted to cinemas for the introduction and acquisition of digital projection equipment and machinery (*Nuove disposizioni applicative dei crediti d'imposta concessi alle imprese di esercizio cinematografico per l'introduzione e acquisizione di impianti e apparecchiature destinate alla proiezione digitale*).

2. Doubts raised by the Commission

- (12) The Commission considered in the opening decision that the measure constituted State aid within the meaning of Article 107(1) TFEU. By offering tax incentives, the Italian State was foregoing certain revenues and therefore the scheme involved State resources. The scheme provided an economic advantage to certain undertakings, in this case cinema exhibitors. Given the international trade in films, this selective advantage might affect trade within the Union. The Commission doubted whether the aid could be considered compatible.
- (13) Firstly, the Commission doubted the **necessity** of the proposed digital cinema tax credit. It questioned the maximum tax credit (of EUR 50 000 per screen) proposed: at a tax rate of 30 %, this corresponded to a maximum eligible installation cost of EUR 166 667 per screen (EUR 50 000 × 100/30). This was higher than the estimated costs of digital projection equipment put forward by the Italian authorities, which was EUR 100 000. The Commission doubted whether the maximum tax credit should be so high and whether the conversion costs put forward were a fair estimate. On top of that, the Commission doubted that the installation of 2K ⁽³⁾ DCI-compliant ⁽⁴⁾ projection equipment was necessary to release Italian or European cultural films.
- (14) Secondly, it doubted the **proportionality** of the proposed aid measure. The Commission noted that larger cinemas were more likely to be able to afford digital projection equipment without public support. Moreover, the Commission noted the availability to exhibitors of commercial transition models, such as the virtual print fee

⁽³⁾ 2K refers to a screen resolution of 2 048 × 1 080 pixels.

⁽⁴⁾ DCI refers to the DCI specifications, originally defined for the US market in 2005 by a joint venture of the US film majors (Disney, Fox, Paramount, Sony Pictures Entertainment, Universal and Warner Bros. Studios), called Digital Cinema Initiatives.

(‘VPF’) models ⁽⁵⁾. It therefore raised the question whether public support on the proposed scale per screen would ‘crowd out’ commercial alternatives.

- (15) Thirdly, the Commission doubted that the proposed tax credit was an **adequate** aid measure. It noted that the estimated budget of the measure (EUR 16,8 million) corresponded to installation costs of EUR 56 million, which was significantly lower than the estimated costs of conversion (EUR 395,7 million on the basis of EUR 100 000 per screen). Next to the adequacy of the available funding, the Commission also questioned whether the proposed measure was sufficiently targeted to achieve the aim of increasing the circulation of cultural Italian and European films. It doubted that the Italian authorities would be able to ensure that digitally equipped exhibitors would introduce alternative commercial models that would offer Italian cinema audiences a wider choice of cultural films. As the use of a tax credit required that a beneficiary must have sufficient tax liabilities and as the measure implied a 70 % investment by the exhibitor, the Commission doubted whether the cinemas most in need of the aid would be able to take advantage of it. The Commission moreover had doubts that the one-off support envisaged (the notification announced a pilot measure of two years) would provide a sustainable solution to the expected shorter lifespan and increased running costs associated with the installation of digital equipment.
- (16) Fourthly, the Commission raised questions on the **economic, social and cultural impact** of the aid. While it recognised that it could be in the common interest for a Member State to use State aid to invest in the transition to digital technology in cinemas, it asked to be assured that the measure would be technologically neutral. In particular, it asked for confirmation that exhibitors would not be induced to invest in one digital standard in preference to another. In addition, it asked the Italian authorities to ensure that films released digitally in an open standards format lower than the digital standard of the support equipment could also be screened. Moreover, it noted that aid for installing digital projection equipment could indirectly benefit the US film majors (in the case of DCI-compliant equipment). The increased demand from the proposed aid might raise the price of the limited supply of projection equipment. As a result of the aid, the critical mass of digital cinemas could be reached more quickly in Italy, which in turn might accelerate the switch to digital distribution and thereby the closure of those cinemas that were not able to install digital equipment by that time. Taken together, the Commission doubted that the potential distortions of competition would be balanced by the social and cultural advantages of the aid.

3. Modifications to the proposed measure since the opening of the procedure

- (17) Following the opening of the investigation procedure by the Commission, the Italian digital cinema tax credit measure has been implemented within the *de minimis* thresholds ⁽⁶⁾. Subject to approval by the Commission, the Italian authorities seek to fully implement the measure beyond the *de minimis* thresholds.
- (18) The Italian authorities estimate that the budget of the measure will amount to approximately EUR 7,5 million for the period 2014-2015.
- (19) The period covered by this decision runs until 31 December 2022. The Italian authorities expect that the tax credit will be used most intensively in the years 2014 and 2015.
- (20) The draft implementing regulations that the Italian authorities seek to implement in full (beyond the *de minimis* thresholds) differ on a number of important points from the original notification.
- (21) First, the requirement for medium and large cinemas to screen a certain amount of Italian and European cultural films as a condition for obtaining the aid has been removed from the modified implementing regulations. In recent years, the Italian authorities have found it difficult to monitor compliance with this requirement in the

⁽⁵⁾ These commercial transition models are based on the payment of a virtual print fee by distributors for the digital projection of their films in cinemas. The VPF system is based on the notion of using some of the savings realised by the distributor that distributes films digitally in order to contribute to the payment of digital equipment costs borne by cinema exhibitors. Typically such VPF deals involve an intermediary third party (an ‘integrator’) that collects VPFs from distributors, and installs and possibly finances the equipment in cinemas. Cf. also recital 50 for an overview of the available VPF models in Italy.

⁽⁶⁾ Until the end of 2010 guided by the Commission communication ‘Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis’ (OJ C 83, 7.4.2009, p. 1). After the end of 2010, the measure was implemented on the basis of Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid (OJ L 379, 28.12.2006, p. 5). In 2013, the Commission adopted a new *de minimis* Regulation, Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid (OJ L 352, 24.12.2013, p. 1).

case of medium to large cinemas. Moreover, they state that removing this requirement is necessary to restore a level playing field between the larger cinemas that need aid and the maxi-circuits that dominate the Italian cinema market (cf. recital 37).

- (22) Second, and linked to this, a threshold of 60 screens is introduced in the modified implementing regulations. Cinema exhibitors that own or manage a higher number of screens are excluded from the tax credit. The Italian authorities consider this a sound alternative to the programming requirements initially imposed as a way of ensuring that the measure reaches its objectives and excluding those market players that, because of their market strength, should be able to make the transition without aid.
- (23) Third, the modified implementing regulations require a declaration from the beneficiary in order to ensure that overcompensation or redirection of aid is avoided if the tax credit is combined with commercial (VPF) models.
- (24) Fourth, the modified regulations allow for the combination of aid up to a maximum aid intensity of 75 % of the total costs. For cinemas of one or two screens, the maximum cumulative aid intensity is 90 %.
- (25) On top of these changes, since 2012 it has been possible for beneficiaries to transfer the digital tax credit benefits to suppliers of digital equipment, banks, financial intermediaries and insurance agencies (cf. recital 56).

III. COMMENTS FROM INTERESTED PARTIES

- (26) The Commission received around 20 submissions from interested third parties in response to the public consultation on the aid measure that was held in 2009. The responses were submitted by:
 - European and Italian trade organisations representing distributors and cinemas, the French Commission Supérieure Technique de l'Image et du Son (CST), and the European Digital Cinema Forum (EDCF),
 - the French authorities, German and UK film funds, and the network of European regional film funds (Cineregio); several contributions also referred to the EFAD publications on the subject ⁽⁷⁾,
 - a number of businesses, film sector professionals and individuals from Italy, France, Switzerland and the UK.

Moreover, a workshop on the subject was held in Rome in October 2009.

- (27) Regarding the **necessity** of the aid, all contributions underlined the need for State aid in the transition to digital cinema, which was seen as an inevitable development. Both the French authorities and the UK Film Council explained that the general benefits of digital cinema were accompanied by an asymmetrical distribution of the costs associated with the transition (carried by the exhibitor) and the direct financial benefits (for the distributor). This asymmetrical situation made it difficult to complete a timely transition without external assistance. In this context, the contributors identified a clear risk that many of Europe's smaller, independent and/or remote cinemas would leave the market if digital projection systems were not made more accessible and affordable. In its Statement of September 2009 the EFAD said that 30 % of European screens were at risk of disappearing. Both the French authorities and the German Federal Film Board emphasised that, in the absence of aid, not only the exhibition of films but also their distribution would suffer. A long transition, with the parallel circulation of analogue and digital film copies, would prove too costly, especially for the smaller film distributors. Ultimately, the absence of aid would have a significant negative impact on European film circulation, cultural diversity and the access of European citizens to culture.
- (28) All contributions also stressed that the so-called DCI standards were widely accepted as the common standard for digital cinema. The promotion of one global standard was seen as a positive element rather than a disadvantage for cinemas because it created a level playing field.

⁽⁷⁾ European Film Agency Directors (EFAD), *San Sebastian Statement: Urgent and comprehensive public support needed for the digitisation of cinemas* (San Sebastian, 21 September 2009), and EFAD background paper — *The case for public intervention in the digital transition of cinema* (October 2009).

- (29) With regard to the costs of installing digital projection equipment, EUR 100 000 per screen was generally not seen as an exaggerated estimate. Instead, several contributors contended that costs could be much higher, for instance when substantial work on the projection booth was required, which could be the case especially for small cinemas. Some contributions nevertheless identified a downward trend in the pricing of digital cinema equipment.
- (30) Several contributions argued that, even if the costs of conversion were much higher than the State support available (as seemed to be the case for the Italian tax credit), the State aid should be seen as complementary to other sources of revenue, for example virtual print fees and exhibitors' own funds.
- (31) Regarding the **proportionality** of the aid, some of the interested parties criticised the tax credit as they expected larger cinemas to be most likely to benefit from the aid. Others argued that aid for larger cinemas could be appropriate, possibly on the basis of programming obligations. Some contributions however echoed the EFAD Statement and stressed that it was important not to introduce differences in treatment, for instance (in the specific Italian tax credit case) arising from the different level of tax liabilities of the cinemas involved, but also (more generally) arising from a restriction of access on the basis of the programming, size and location of cinemas. The International Federation of Film Distributors' Associations (FIAD) argued that even major exhibitors might not be considered profitable in the current cinema market and general economic context.
- (32) On the availability of commercial business models for the transition and their applicability to smaller cinemas, opinions diverged somewhat. Some argued that there was no standard business model for the digital cinema transition. Others argued that a large number of cinemas could not access the VPF deals offered by third-party integrators (cf. also footnote 5) because of the nature and volume of their programming (the volume of virtual print fees generated depended on the number of films programmed in their first week of release and/or the number of screens the cinema had). Europa Distribution argued that the commercial business models worked only for the more profitable cinemas and big, commercial distributors. According to the EFAD background paper, only approximately 10 000 European screens out of a total of 30 000 could be equipped through the VPF model. One contribution claimed that the commercial VPF models were equally suited for smaller cinemas. In any case, the French authorities argued that the available commercial transition models did not cover all the costs of digital cinema conversion (such as the upgrade of projection booths) and moreover always required a contribution by the cinema exhibitor as well. Public support could play a crucial complementary role in these cases too.
- (33) Regarding the **adequacy** of the aid, interested parties said that, in general, State aid would help smaller cinemas to face the strong competition of large multiplex cinemas and would create a level playing field. The installation of digital cinema equipment was expected to result in a wider choice for audiences. Contributors also emphasised other advantages associated with digital cinema, such as the quality of the projection, the programming flexibility and the lower distribution costs. The French authorities argued that the adequacy of digital cinema support should be looked at not in terms of an increase in programming diversity, but rather in terms of preventing the closure of cinemas. It was in their view through the digitisation of the diverse types of cinema that a diverse range of films would be offered. The European Digital Cinema Forum argued that, if the tax credits could be offset against VAT, even the less profitable cinemas would be able to benefit from the Italian measure.
- (34) Some contributions did mention the short-term nature of the tax credit and contrasted this with the longer-term challenges posed by the digital cinema transition. However, it was also argued that the standards were sufficiently established to guarantee that they would last for at least a decade, or that the lifespan of digital cinema equipment could not yet be determined. The German Federal Film Board said that support for the digital cinema transition would be less costly than the costs associated with rebuilding cinemas and cultural diversity that would be needed after the disappearance of those players that were unable to finance the transition themselves. Germany also emphasised that the specific national and regional context of each Member State would require a specifically designed aid measure and a tailored form of aid. The EFAD Statement echoed this sentiment and emphasised that there was no one-size-fits-all solution. The Italian association of cinema exhibitors (ANEC)

expected that the context would have changed sufficiently by the end of the lifespan of the digital equipment to make replacement less of a challenge. The European Digital Cinema Forum moreover stated that any additional running costs might be offset by new revenue streams for the cinemas concerned.

- (35) Regarding the **economic, social and cultural impact** of the aid, the contributions generally emphasised the need for one digital cinema standard and the wide recognition of DCI standards. The EFAD Statement argued that support for digital cinema should not impose a technological solution but should at the same time take stock of the technological situation in the sector. Europa Distribution's contribution warned that failure to follow the industry standard would lead to the closure of many cinemas. In any case, ANEC confirmed that cinemas were free under the measure to invest in the standard of their choice. Several contributions argued that DCI-compliant equipment could also be used to screen alternative programmes of different (lower) digital standards, whereas the reverse (screening DCI-compliant film copies on, e.g. 1,3K equipment) was not possible. The contributors did not identify a risk of price increases. Instead, prices were expected to fall over time. Both the contribution of the French authorities and the EFAD background paper emphasised in this respect that any aid measure should be designed with a view to avoiding the distortion of competition in the digital equipment market. Any aid measure should therefore be based on an evaluation of digital equipment costs and the aid should be capped in line with those cost estimates. The Commission's concern that State aid might accelerate the switch-over and with it the closure of cinemas (cf. recital 16) was not reflected in the contributions. Instead, State aid was put forward as a sustainable solution to the digital cinema challenge. The Italian federation of arthouse cinemas drew attention to the limited geographic reach of cinemas, which it said meant that the distortive effects on competition would be small.

IV. COMMENTS FROM ITALY

1. Necessity of aid

- (36) The Italian authorities have provided the Commission with information on the characteristics of the Italian cinema market (last updated in October 2013). The total number of Italian screens is estimated at 3 936, located in 1 872 cinema sites. Four categories can be distinguished:
- (a) big cinema networks ⁽⁸⁾ of more than 60 screens. There are only two such networks, UCI and The Space. They represent 787 screens in 76 sites;
 - (b) small cinema networks. There are 15 such networks, each comprising in total 60 screens or less. In total, the cinemas in this category represent 513 screens in 104 sites;
 - (c) small commercial cinemas. These account for 1 287 screens, located in 351 cinema sites;
 - (d) smaller sites, comprising almost only single-screen cinemas (90 % of the sites), alongside seasonal cinemas and/or church cinemas. There are 1 340 such sites, corresponding to an estimated 1 500 screens.
- (37) While the largest cinema networks (category (a)) represent 40 % of the national market share, the cinemas in category (d) account for only 5 to 10 % of the market share.
- (38) The tax credit scheme targets the cinemas in categories (b) to (d). In particular in view of the strong market presence of the two big cinema networks, the Italian authorities consider that State aid is necessary to complete the digital transition of these cinema exhibitors, which are all small or medium-sized.

⁽⁸⁾ The Italian authorities have defined a cinema network as a company owning at least 15 screens in a minimum of three cinema sites.

- (39) According to data provided by the Ministry of Culture and Tourism a total of 1 603 screens applied for digital cinema tax credits during the period 2010–2013 (April 2014 data). The measure, implemented within the *de minimis* rules, proved particularly popular immediately after its launch in 2010, when 671 screens benefited.
- (40) Yet the implementation of the aid measure under the *de minimis* rules has proved insufficient to turn the situation round. In particular medium-sized multi-screen cinemas have, as a result, been able to digitise only some of their screens.
- (41) The Italian authorities say that the digitisation of Italian cinemas is still lagging behind. In October 2013, the digitisation rate stood at about 62 % ⁽⁹⁾. According to estimates provided by the Italian authorities in June 2014, at least 700 cinema screens remain to be digitalised.
- (42) As a result, a considerable number of cinemas, mostly small to medium-sized, are at risk. Their disappearance would not only signify job losses at the level of exhibitors, but would in turn impact the distribution of films and restrict choice for the audience.
- (43) The Italian authorities have in particular highlighted the role of single-screen cinemas and medium-sized cinemas in Italy. The continuing presence of the first group is crucial to ensure equal access for all citizens to cinemas, including those located in small rural and mountain towns. The second group of medium-sized cinemas forms the backbone of the distribution and exhibition of quality films in Italy. Their continuing presence is important as they offer an alternative to the two large cinema networks that dominate the market.
- (44) The Italian authorities expect that traditional film will completely disappear from the market within a period of only a couple of weeks or months. As the cut-off point draws nearer, the Italian authorities stress the need to implement the measure beyond the *de minimis* thresholds.
- (45) With regard to the maximum tax credit proposed (EUR 50 000 per screen) and the estimated costs of digital projection equipment, the Italian authorities have adjusted their estimates of the average cost of digital conversion per screen to EUR 50 000–60 000 (figures provided in April and June 2014). The maximum tax credit in other words corresponds to conversion costs that are significantly higher than the estimated average conversion costs. However, the Italian authorities argue that the tax incentives are calculated on the basis of a percentage of the expenses that are actually incurred. Based on an average investment of EUR 50 000, the tax incentive provided (at 30 %) would equal EUR 15 000. In practice, therefore, the maximum tax credits have not as a rule been applied. Nevertheless, the maximum cap guarantees that, in case of atypically high conversion costs, the aid amounts remain limited in absolute terms.
- (46) With regard to the necessity of aid, it is furthermore important to note that the latest indications by the Italian authorities still point to a cost of digital conversion amounting to several tens of thousands of euros per screen. For many cinemas, especially the smaller ones, it is not possible to raise these funds from private sources, especially in the current Italian and European economic climate.

2. Proportionality of aid

- (47) In general terms, the Italian authorities stress that the tax credit is complementary to the commercial transition models and is not in a competitive relationship with VPF models.
- (48) The modified implementing regulations contain a number of provisions that ensure that the aid measure remains proportional. These take into account the market mechanisms available for digital cinema conversion (i.e. the VPF models).

⁽⁹⁾ Data of the national association of cinema exhibitors (ANEC), provided by the Ministry of Culture and Tourism.

- (49) First of all, only cinema exhibitors of 60 screens or less may apply for tax benefits. This means that the two Italian maxi-circuits (UCI and The Space) are excluded from the aid. The Italian authorities say that the classic VPF model has been applied successfully to the conversion of these dominant market players. Moreover, taking into account their market strength (cf. recital 37), they should not be dependent on State aid for digital conversion.
- (50) According to the information provided by the Italian authorities, the two large cinema networks are the only ones that have made use of the classic VPF model. However, smaller cinema operators have also accessed commercial mechanisms to facilitate their digital transition. An alternative VPF model, tailored for medium to small cinemas, has been developed in Italy on the basis of an agreement between the distributors' and exhibitors' associations. The table below outlines the main differences and similarities between the classic and alternative VPF models as implemented in Italy.

Comparison between the classic and alternative VPF models in Italy

The classic VPF model in Italy	The alternative VPF model in Italy
A third party 'integrator' (which in turn has VPF contracts with distributors) signs an agreement with a cinema exhibitor.	Based on an agreement between the distributors' association and the exhibitors' association. There are no third parties involved.
The exhibitor does not own the digital equipment and does not pay for it up-front.	The exhibitor owns the digital equipment from the start and covers the entire purchase cost up-front.
Both the distributors and the exhibitor contribute to the gradual amortisation of costs through respectively VPF fees and monthly payments. The division of costs is typically 75 % for distributors and 25 % for exhibitors.	Film distributors pay virtual print fees for digital screenings of films. These fees may cover up to 75 % of the digital conversion costs. The exhibitor is in any case expected to cover EUR 5 500 of the costs.

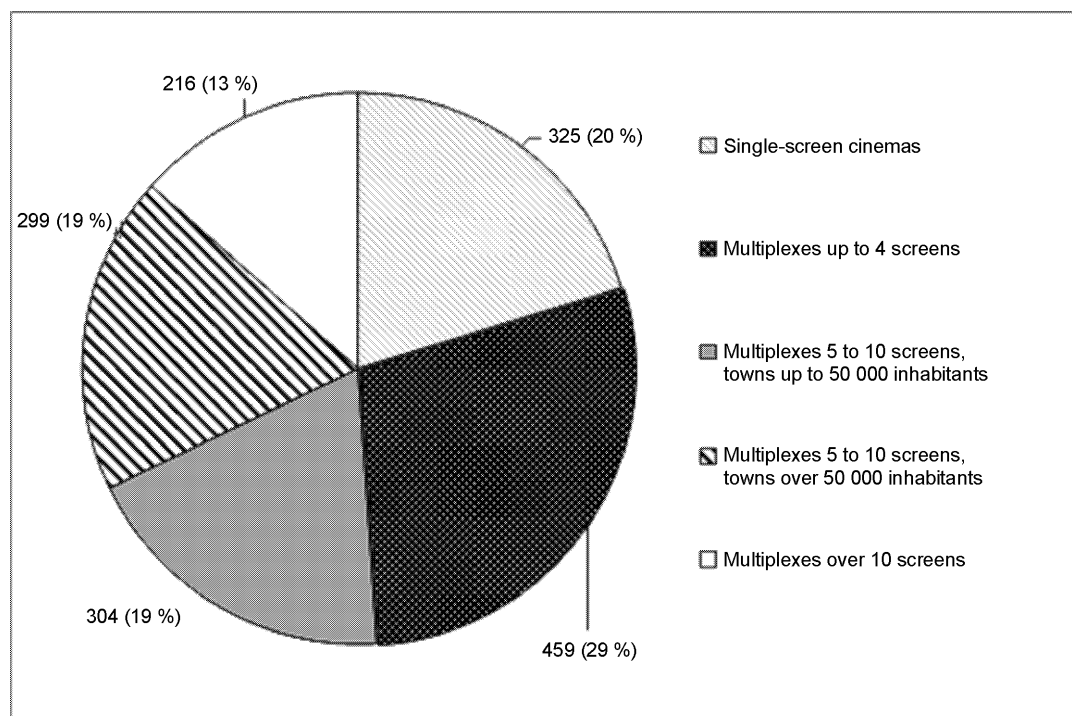
- (51) Secondly, taking this into account, the Italian authorities have modified the implementation regulations to ensure there is no overcompensation or redirection of aid if the tax credit is combined with any of the commercial (VPF) models. A declaration is required from the beneficiary that the tax benefit is requested to cover only its own effective costs (cf. recital 23). The Italian authorities have stated that checking by the Ministry of Culture and Tourism, on a case-by-case basis, will guarantee that the aid covers only the part of the investment that effectively has to be carried by the cinema exhibitor.
- (52) Thirdly, maximum cumulative aid intensities have been introduced to keep the aid measure proportionate. These distinguish between the smallest cinema sites (with one or two screens) and other cinemas (cf. recital 24).

3. Adequacy of aid

- (53) In the opening decision, the Commission doubted that the estimated budget of the measure was sufficient to cover the estimated costs of conversion. The updated budget and cost estimates provided by the Italian authorities (cf. recitals 18 and 45) give an updated assessment of the situation addressed by the aid measure. On the basis of an average tax credit of EUR 15 000 and taking into account the estimated budget of the scheme (cf. recital 18), the measure could benefit 500 screens over the period 2014-2015, when the aid measure is expected to be used most intensively. This corresponds to a substantial part of the screens that remain to be digitalised (cf. recital 40).
- (54) While the cultural programming requirement has been removed from the aid scheme, the Italian authorities have argued that the scheme still has a strong cultural objective. The achievement of the complete digitisation of the Italian cinema market will result in a better circulation of different types of film and increase circulation potential for 'niche' works. If the various types of cinema in Italy could not all make the digital transition, culture would suffer.

- (55) The Italian authorities maintain that the tax credit measure implies an offset against not just direct taxes owed to the Italian Revenue Agency (corporate tax) but also indirect taxes (such as VAT) and withholding tax and social security obligations (paid by employers on behalf of their employees). All these taxes are taken into account when calculating the tax credit benefits. This increases the accessibility of the scheme, as its use does not depend on the level of profits realised by the undertaking concerned.
- (56) Moreover, Article 51 of Decree-Law 83 of 2012 introduced the possibility of transferring tax credits to suppliers of digital equipment, banks, financial intermediaries and insurance agencies (cf. recital 25). This increases the accessibility of the aid measure for the smaller cinemas, especially if they are family-run and have no employees.
- (57) Already during the implementation of the measure under *de minimis* rules, the tax credits have been of benefit to all types of cinema, including the smallest cinemas in the market. The pie chart below gives an overview of the beneficiaries of the scheme (2010-2013) demonstrating this.

Beneficiaries per type of cinema (2010-2013, based on the number of screens) (data last updated in April 2014 and provided by the Ministry of Culture and Tourism)



- (58) The data provided moreover show a marked increase in the number and share of small cinemas benefiting from the tax credit in 2012 and especially 2013. All in all, according to data received from the Italian authorities, 325 cinemas or 24,3 % of the 1 340 smallest cinema sites in Italy were able to use the tax credit to make the digital transition between 2010 and the end of 2013.

4. Economic, social and cultural impact

- (59) The Italian authorities stress the cultural importance of ensuring a comprehensive digital cinema transition. The installation of digital equipment brings with it a number of important advantages (such as increased flexibility) for the whole cinema sector (and ultimately cinema audiences). Yet the costs of conversion are high and unequally spread, with cinemas carrying most of the burden. In particular the smaller market players are not able to make the transition without State aid. The market transition (VPF) models developed do not suffice to offset this imbalance and not all cinemas can access them to the same extent.
- (60) The Italian authorities confirm that, in their view, the scheme's mechanisms do not call into question the principle of technological neutrality.

V. ASSESSMENT OF THE AID MEASURE

1. Existence of aid

- (61) Article 107(1) TFEU states that ‘Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.’
- (62) As explained in the opening decision and more briefly in recital 12, the measure constitutes State aid within the meaning of Article 107(1) TFEU. The source of funding is tax incentives, so the Italian State is foregoing certain tax revenues. Under the scheme, certain film companies will benefit from this financial advantage, and the measure therefore provides a selective advantage to certain undertakings. The beneficiaries compete with other undertakings that do not necessarily benefit from the scheme. Consequently the scheme distorts or threatens to distort competition. In view of the international trade in films, the measure may affect intra-Union trade.

2. Compatibility of the aid

- (63) The Italian authorities justify the measure as aid to promote culture. They have continually stressed the cultural importance of completing the digital cinema roll-out in Italy as soon as possible. The aid measure aims to ensure that all types of cinema are able to make the digital transition, despite the high costs of conversion.
- (64) When the opening decision on the measure was adopted, the Commission had not defined its policy on digital projection support. Since then, the Commission has adopted a new communication on State aid for films and other audiovisual works ⁽¹⁰⁾, which updated the rules used for assessing the compatibility of State aid for films and other audiovisual works under Article 107(3)(d) TFEU.
- (65) The new Cinema communication explicitly acknowledges that aid to cinemas may be assessed as aid to promote culture within the meaning of Article 107(3)(d) TFEU. Therefore the compatibility of the aid at issue here may be assessed under this provision. The Cinema communication stipulates that aid for the modernisation of cinemas, including their digitisation, can be justified on that basis if such aid is necessary, proportionate and adequate.

(a) *Necessity of the measure*

- (66) As demonstrated by the Italian authorities and confirmed by the comments from interested parties, the digital cinema transition poses a challenge for the film sector that affects European cinema as a whole, and smaller cinemas in particular. The disappearance of cinemas, in particular independent small and medium-sized venues in smaller towns, would reduce the diversity and regional reach of the films offered. In other words, a long and uneven transition has a negative impact on film exhibition, distribution and, ultimately, European audiences.
- (67) Despite the implementation of the tax measure under the *de minimis* rules, Italy continues to lag behind in the digital cinema transition.
- (68) At the same time, as the market has passed the ‘tipping point’ of conversion, with more than 60 % of the screens in Italy digitalised at the end of 2013, the situation has worsened for those cinemas that are dependent on State aid to make the transition. Indeed, the availability of 35 mm films is not guaranteed in the short term.
- (69) The measure targets not only the smallest cinemas, but also larger commercial cinemas and networks. However, the largest cinema networks (of more than 60 screens) are excluded from aid. The Italian authorities have argued that the tax benefits granted to all cinemas of a lesser size reinstates a level playing field in the sector, which is dominated by two very large cinema networks.
- (70) The tax credit aims to help those cinemas that are unable, especially in the current economic climate, to raise sufficient private funds for a costly cinema conversion.

⁽¹⁰⁾ Communication from the Commission on State aid for films and other audiovisual works (OJ C 332, 15.11.2013, p. 1).

- (71) Taking into account the above, the Commission considers that the aid measure can be considered necessary to retain and restore a diverse cinema landscape in Italy in a digital context. The continued presence of different types of cinema, from single-screen arthouses to multi-screen venues with commercial programming, is crucial to help ensure that a diverse range of cinema continues to be offered to the Italian public. As recognised by the submissions received from interested parties, the digital cinema transition challenges the film sector as a whole, with only the largest cinema networks easily accessing commercial transition models. The market data supplied by the Italian authorities have demonstrated that the *de minimis* implementation of the measure has not sufficed to complete this transition, especially for those cinemas that have more than one screen. Even if it is true that certain cinemas were able to access VPF deals, it is also true that commercial transition models do not cover all the costs of the digital cinema conversion (cf. recital 32). Public support can be considered necessary in these cases too, as long as it is designed in a complementary fashion, ensuring that the measure remains proportional regardless of the type of cinema concerned.

(b) Proportionality of the measure

- (72) The Italian authorities have excluded cinema exhibitors of more than 60 screens from the tax credit. The Italian cinema market structure shows a clear gap between operators of up to 60 screens and those of a larger size (cf. recitals 36 and 37). The threshold introduced therefore seems proportional in view of the objective of the scheme.
- (73) Moreover, the tax credit covers only part (30 %) of the transition costs and is capped at EUR 50 000 per year. By making the amount of aid a percentage of actual digitisation costs, the Italian authorities have guaranteed that the aid remains proportionate, even when the costs may vary on a case-by-case basis. As several contributors pointed out (recital 29), the costs for digitisation can rise significantly above average in some cases, for instance when substantial work on the projection booth is required. In such atypical cases, the cap of EUR 50 000 nevertheless ensures that the absolute aid amounts remain proportionate.
- (74) Whereas the opening decision raised questions on the 'crowding out' of commercial digital cinema conversion models, recital 50 demonstrates that two different commercial conversion models have been developed in Italy. They can be combined with the proposed digital cinema tax credit. The Italian authorities have included specific provisions in the modified implementing regulations to ensure that the combination of private and public digital cinema conversion financing does not result in overcompensation or redirection of aid (e.g. to distributors or VPF integrators). In this way, the Italian authorities promote an optimal synergy between the available market models and State aid, in order to foster a complete digital roll-out.
- (75) The tax credit can also be combined with other aid measures. In order to ensure the proportionality of the aid, the Italian authorities have introduced maximum cumulative aid intensities of 90 % for small cinema sites (single- and two-screen cinemas) and 75 % for other types of cinema.
- (76) More generally, the application has to be accompanied by a certified document specifying the actual expenditure incurred for each screen and checks are to be carried out by the Ministry of Culture and Tourism on a case-by-case basis. The implementing regulations moreover indicate that the tax credit will be recovered (plus interest and penalties) if the requirements are not met.

(c) Adequacy of the measure

- (77) The clarifications provided by the Italian authorities, and the introduction of the transferability of the tax credits, ensure that the measure will have an impact on the intended beneficiaries of the scheme. Even the least profitable cinemas should be able to access the scheme.
- (78) The measure is no longer proposed as a pilot measure, but would be in force until the end of 2022.

- (79) The data provided by the Italian authorities (recitals 57 and 58) demonstrate the accessibility of the measure to all types of cinema targeted, in particular the smaller ones. While other factors may play a role, it should be noted that the marked increase in the number of cinemas of 1 to 4 screens benefiting from the tax credits (under the *de minimis* rules) in 2012 and 2013 coincides with the introduction of the transferability of the tax credits in 2012 (recital 25).
- (80) More generally, the measure seems adequate for the purpose of safeguarding the diversity of cinemas present on the Italian market, ranging from single-screen outfits to small commercial cinemas and various types of multiplex cinema. This diversity of screens is a prerequisite for achieving a diverse range of films offered on those screens.

(d) Distortion of competition and effect on trade

- (81) The distortions of competition and the effect on trade are limited. The cross-border effect of cinemas is limited to the presence of international cinema operators and the international dimension of the film trade in general. However, individual cinema locations have an inherently limited geographic reach, as audiences will not travel far to visit a cinema.
- (82) The measure relates to investment aid and provides a one-off benefit to cinemas that are facing a one-off transition. The tax credit ensures that all cinemas can complete the digital switch-over, but does not unduly distort competition in terms of their daily operation.
- (83) The completion of the digital cinema transition across Europe is moreover expected to benefit the European film industry as a whole. In this regard, the doubts on digital cinema standards raised in the opening decision are no longer relevant. The contributions from third parties have shown that there is a consensus in the trade in favour of the prevalent digital cinema standards.

VI. CONCLUSION

- (84) In the light of the foregoing, the Commission takes the view that the aid pursues a well-defined cultural objective. The doubts with regard to necessity, proportionality, adequacy and impact raised in the opening decision have been addressed. The distortions of competition and the effects on trade that the measure will have are limited in such a way that they are not contrary to the common interest. Accordingly, the tax credit for digital projection equipment can be considered compatible with the internal market on the basis of Article 107(3)(d) of the Treaty on the Functioning of the European Union,

HAS ADOPTED THIS DECISION:

Article 1

The State aid measure which Italy is planning to implement for digital projection equipment on the basis of Law No 244 of 24 December 2007, Decree-Law No 91 of 8 August 2013 and the draft provisions implementing the tax credit granted to cinemas for the introduction and acquisition of digital projection equipment and machinery is compatible with the internal market within the meaning of Article 107(3)(d) of the Treaty on the Functioning of the European Union.

Implementation of the aid measure is accordingly authorised.

Article 2

This decision is addressed to the Italian Republic.

Done at Brussels, 29 October 2014.

For the Commission
Joaquín ALMUNIA
Vice-President

