

EU General Court Strikes Down Commission Decisions Authorizing EUR 7 Billion State Aid to Lufthansa and Scandinavian Airlines

June 14, 2023

On May 10, 2023, the General Court annulled two Commission decisions authorizing a total of EUR 7 billion recapitalization aid granted during the COVID-19 pandemic to air carriers Lufthansa and Scandinavian Airlines (“SAS”), following a challenge brought by rival airlines Ryanair and (for the Lufthansa decision) Condor:¹ *i.e.*, (i) EUR 6 billion from Germany to Lufthansa² and (ii) EUR 1 billion from Denmark and Sweden to SAS.³ The judgments mark the first time the General Court has annulled Commission decisions clearing recapitalization measures adopted under Section 3.11 of the COVID-19 Temporary Framework (“TF”), and the largest amount of previously cleared aid covered by an annulment judgment.⁴

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¹ *Ryanair v Commission* and *Condor Flugdienst v Commission* (Joined Cases T-34/21, and T-87/21) EU:T:2023:248 (“Lufthansa Judgment”); and *Ryanair v Commission* (Case T-238/21) ECLI:EU:T:2023:247 (“SAS Judgment”).

Cleary Gottlieb represented Ryanair in these proceedings.

² *COVID-19 – Aid to Lufthansa* (Case COMP/SA.57153) – Commission Decision of December 14, 2021 (“Lufthansa Decision”). The measure was a EUR 6 billion recapitalization consisting of one equity participation (EUR 306,044,326.40) and two silent participations: (i) one which is a hybrid capital instrument treated as equity under international accounting standards (Silent Participation I of EUR 4,693,955,673.60) and (ii) one which is a convertible debt instrument (Silent Participation II of EUR EUR 1.0 billion). The measure is part of a wider series of support measures for the Lufthansa Group including State aid by the German, Austrian, Belgian and the Swiss governments.

³ *Sweden and Denmark – COVID-19 recapitalisation of SAS* (Case COMP/SA.57543) – Commission Decision of August 17, 2020 (“SAS Decision”). The overall budget allocated to the measure was approximately SEK 11 billion (EUR 1,069 million) allocated by Denmark and Sweden by means of equity and hybrid capital instruments. The recapitalization plan also included the conversion of existing hybrid notes into common shares and the conversion of bonds into new commercial hybrid notes or common shares.

⁴ Communication from the Commission on Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak 2020/C 91 I/01, C/2020/1863, OJ C 91 I, as last amended on May 8, 2020.

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The General Court found that the Commission committed multiple errors, each of which warranted the annulment of the decisions.

In the Lufthansa judgment, the General Court found that the Commission had erred by (i) considering that Lufthansa was unable to obtain financing on the markets for the entirety of its needs (*see* Section I below); (ii) failing to require a step-up mechanism, or a comparable alternative, to incentivize Lufthansa to buy back Germany's shareholding (*see* Section II below); (iii) accepting a price for Germany's acquisition of Lufthansa's shares at the time of the conversion of Silent Participation II into equity that did not comply with the TF (*see* Section III below); (iv) denying that Lufthansa held significant market power ("SMP") at a number of airports, including Vienna and Düsseldorf airports (*see* Section IV below); and (v) accepting commitments from Germany that did not preserve effective competition (*see* Section V below).

In the SAS judgment, the General Court similarly found that the Commission had failed to demonstrate that the "overall structure" of the measure, consisting of a hybrid capital instrument and an equity instrument, incentivized SAS to buy back Sweden's and Denmark's shareholding in line with the step-up mechanism required by the TF (*see also* Section II below).

I. Lufthansa Could Have Obtained at Least Part of its Financing Needs in the Market (Recital 49(c) TF)

The General Court found that the Commission had failed to verify whether Lufthansa could have obtained at least part of its financing needs on the market at affordable terms pursuant to Recital 49(c) TF.⁵

⁵ Lufthansa Judgment, para. 132. According to Recital 49(c) TF, to be eligible for a recapitalization measure, the beneficiary must, *inter alia*, be "not able to find financing on the markets at affordable terms".

⁶ Lufthansa Judgment, paras. 121 and 134. According to the statement of Lufthansa's CFO of 19 March 2020, the Lufthansa Group was "financially well equipped to cope with an extraordinary crisis situation such as [the COVID-19 crisis]", in particular because it owned "[86%] of the Group's fleet, which is largely unencumbered and [had] a book value of around [EUR] 10 billion".

Based on economic reports submitted by Ryanair, as well as public statements from Lufthansa's Chief Financial Officer (CFO),⁶ the General Court upheld Ryanair's argument that, even in a conservative scenario, Lufthansa could have raised between EUR 1-3.7 billion in debt financing by using its aircraft and spare parts as collateral (worth *c.* EUR 10 and 2.3 billion respectively).⁷ In contrast, the Commission Decision had merely noted that Lufthansa did not have "sufficient collateral" to obtain financing on the market, without however substantiating these claims.⁸ Moreover, the General Court concluded that the Commission erred in law by claiming that under Recital 49(c) TF, in order to be eligible for the aid, the beneficiary must be unable to find alternative financing on the market "over the entire amount" required to ensure its solvency or liquidity. In other words, the Court ruled that a beneficiary can only receive aid for the amounts that it is unable to raise on the markets.⁹

II. The Commission Failed to Require Step-Up Mechanisms (or a Comparable Alternative) to Incentivize Lufthansa and SAS to Redeem the Aid

Under the TF, Member States granting COVID-19 aid in the form of a recapitalization (equity or hybrid instruments) must provide: (i) a "step up" mechanism, *i.e.*, an increase of the State's remuneration or the attribution to the State of additional shares for free, in case the State has not exited after two years (equity) or four years (hybrid); or (ii) a comparable alternative overall leading to a similar outcome.¹⁰ In both the Lufthansa and SAS judgments, the General Court found that the Commission had failed to require such "step-up" or comparable mechanisms.

⁷ Lufthansa Judgment, paras. 118-119.

⁸ Lufthansa Judgment, paras. 122-124; Lufthansa Decision, para. 22: "[Lufthansa] would not have sufficient collateral for securitized debt instruments over the entire amount at current loan to values and market values".

⁹ Lufthansa Judgment, paras. 122 and 128-132; Lufthansa Decision, para. 22 (*see* footnote 8 *supra*).

¹⁰ *See* Recitals 61 and 62 TF for equity instruments and Recitals 68 and 70 TF for hybrid instruments.

The General Court rejected the Commission's claims that the application of other requirements of the TF was a proper alternative to the step-up mechanisms. In particular, the Commission had erroneously invoked:

- (i) The significant *ex ante* discount on the price paid by Germany and Sweden/Denmark for Lufthansa's and SAS' shares respectively, which complied with the separate requirement of Recital 60 TF. The Court concluded that, unlike the step-up mechanisms, Recital 60 TF is not "*intended to be an ex post incentive to the beneficiary concerned to buy back that shareholding as quickly as possible*".¹¹
- (ii) The increasing interest rate of Silent Participations I and II (Lufthansa), and the increasing coupon for the State hybrid notes (SAS), which complied with the remuneration requirement of hybrid capital instruments before their conversion into equity laid down in Recital 66 TF. But the Court concluded that these measures did not comply with the separate step-up remuneration requirement required by Recitals 68 and 70 TF for hybrid instruments after their conversion.¹²
- (iii) The behavioral commitments set out in Section 3.11.6 TF, such as the bans on payment of dividends or aggressive commercial expansion. The Court concluded that these commitments pursue other objectives than the step-up requirements, *i.e.*, preventing the use of tax-payer money to fund corporate dividends or artificially distort competition.¹³

- (iv) The obligation to notify a restructuring plan if, six years after the recapitalization the State's intervention has not been reduced to below 15% of the total equity of the beneficiary pursuant to Recital 85 TF.¹⁴

In addition, the General Court rejected the Commission's argument that Germany's and Sweden/Denmark's shareholdings in Lufthansa and SAS respectively were "*undesirable*", finding that these statements are subjective and lack any legal force.¹⁵

III. The Commission Erred in Accepting a Price for Lufthansa's Shares at the Time of the Conversion of Silent Participation II into Equity that Departed from the TF

Recital 67 TF indicates that the conversion of hybrid capital instruments into equity must be conducted at a level that is at least 5% below the Theoretical Ex-Rights Price (TERP) at the time of the conversion.¹⁶

The General Court found that the Commission had erred in accepting that Germany could acquire Lufthansa's shares when converting Silent Participation II into equity at a price that did not follow the methodology set out in Recital 67 TF.¹⁷ In particular, the Commission authorized Germany to convert (i) part of Silent Participation II into shares at a fixed price of EUR 2.56 per share, while (ii) another part of Silent Participation II at the actual trading price of the shares at the time of conversion minus 10% or 5.25%. The Court considered that such alternative methodology could yield a higher price than that provided for under the TF and the Commission did not offer any explanations for such departure from the TF.¹⁸

The General Court also dismissed the Commission's claim that Germany had undertaken to seek authorization *ex post* if the conversion price was

¹¹ Lufthansa Judgment, paras. 253-257 and 265. SAS Judgment, paras. 56-60.

¹² Lufthansa Judgment, paras. 259-261. SAS Judgment, para. 61.

¹³ Lufthansa Judgment, para. 262.

¹⁴ SAS Judgment, paras. 68-71.

¹⁵ Lufthansa Judgment, paras. 258 and 266-267. SAS Judgment, para. 62.

¹⁶ TERP is the theoretical market price of a stock after the completion of a new rights issue.

¹⁷ Lufthansa Judgment, paras. 274-279.

¹⁸ Lufthansa Judgment, paras. 274-279; Lufthansa Decision, para. 158.

higher than the price calculated following Recital 67 TF.¹⁹ The General Court observed that, (i) in general, the Commission cannot postpone its compatibility decision if the aid measure is liable to infringe State aid rules;²⁰ and, (ii) in particular, Germany had failed to commit, “*in substantive terms*”, to ensure that it would actually acquire Lufthansa’s shares at a price compliant with Recital 67 TF.²¹

IV. The Commission Failed to Adequately Assess Lufthansa’s SMP at a Number of Airports

Recital 72 TF states that “[i]f the beneficiary of a COVID-19 recapitalisation measure above EUR 250 million is an undertaking with significant market power on at least one of the relevant markets in which it operates, Member States must propose additional measures to preserve effective competition in those markets. [...]” The Commission assessed whether Lufthansa held SMP at nine “coordinated airports” where Lufthansa had a “base”,²² namely Berlin Tegel, Brussels, Düsseldorf, Frankfurt, Hamburg, Munich, Palma de Mallorca, Stuttgart and Vienna airports. However, in the course of the written proceedings, the Commission recognized that it had erroneously considered that Hannover airport was not a coordinated airport. The Commission issued a Corrigendum amending its Decision and also assessed

whether Lufthansa held SMP at Hannover airport (i.e., the ten “relevant airports”).²³

In the Lufthansa judgment, the Court clarified the notion of SMP under Recital 72 TF, equating it to the notion of dominance under Article 102 TFEU by reference to definition of SMP set out in recital 161 and Article 63(2) of Directive (EU) 2018/1972 on the European Electronic Communications Code.²⁴ The Court then concluded that the Commission had infringed Recital 72 TF by rejecting that Lufthansa held SMP at a number of the relevant airports.²⁵

First, the General Court found that the Commission had failed to consider all the relevant factors to assess whether Lufthansa held SMP at the relevant airports.²⁶ In particular, the General Court noted that in its assessment of market power the Commission had only considered criteria relating to airport capacity, such as slot holdings²⁷ and congestion rates at airports (i.e., barriers to entry).²⁸ This excluded other relevant criteria such as the beneficiaries’ shares of flights or seats (i.e., actual market shares).²⁹ The General Court observed that Lufthansa’s market shares sometimes largely exceeded its share of slots at the relevant airports.³⁰ The General Court thus invited the Commission to reassess Lufthansa’s SMP at the

¹⁹ Lufthansa Judgment, paras. 280-286.

²⁰ Lufthansa Judgment, paras. 283 and 285.

²¹ Lufthansa Judgment, para. 284.

²² Lufthansa Decision, footnote 23 defines a “base” as an airline having “*aircraft overnight at the airport, and are used to operate several routes from that airport.*” According to IATA, coordinated or ‘level 3’ airports, are airports where demand for airport infrastructure significantly exceeds the airport’s capacity during the relevant period.

²³ See Lufthansa Judgment, paras. 349-357; see also Decision correcting Decision C(2020) 4372 final of 25 June 2020 concerning State Aid SA.57153 (2020/N) – Germany – COVID-19 – Aid to Lufthansa, available here: https://ec.europa.eu/competition/state_aid/cases1/202204/SA_57153_70FA6D7E-0000-C963-B9A0-AF1E950E5789_551_1.pdf.

²⁴ Lufthansa Judgment, paras. 364-368. Directive (EU) 2018/1972 of the European Parliament and of the Council of 11 December 2018 establishing the European Electronic Communications Code (Recast), OJ L 321 17.12.2018, p. 36, recital 161: “*The definition of significant*

market power used in this Directive is equivalent to the concept of dominance as defined in the case-law of the Court of Justice”.

²⁵ Lufthansa Judgment, paras. 359-412.

²⁶ Lufthansa Judgment, paras. 373-387.

²⁷ Lufthansa Decision, para. 180 defines “*slot holding*” as the “*ratio between the number of slots held by an air carrier (or the air carriers that are part of the same group) [...] at an airport and the total available slots at that airport (i.e., the airport capacity)*”.

²⁸ “*Congestion rate*” is the proportion of slots allocated to all airlines at the airport concerned in relation to the total capacity of the airport in terms of slots.

²⁹ Lufthansa Judgment, paras. 375-382. In particular, the General Court noted that slot holdings are not a direct indicator of market power because, during a time slot, airlines can (i) operate aircraft of different sizes, thus transporting different numbers of seats, or (ii) operate different number of flights depending on their schedule or efficiency (see Lufthansa Judgment, para. 379).

³⁰ Lufthansa Judgment, paras. 380 and 390-393.

relevant airports based on more accurate market shares.³¹

Second, based on the figures provided in the Lufthansa decision, the General Court found that the Commission had manifestly erred in its assessment by inconsistently assessing Lufthansa's SMP at certain airports. More specifically, the same criteria (slot holdings and congestion rates) that led the Commission to conclude that Lufthansa held SMP at Frankfurt and Munich airports should have equally led the Commission to conclude that Lufthansa held SMP in Düsseldorf and Vienna.³²

V. The Commission Accepted Commitments from Germany that Did Not Preserve Effective Competition

Under Recital 72 TF, where the Commission finds that the beneficiary holds SMP on any market, "Member States must propose [...] structural or behavioural commitments foreseen in Commission Notice on remedies acceptable under the [EU Merger Regulation]." The Commission concluded that Lufthansa held SMP at Frankfurt and Munich airports and, accordingly, accepted Germany's commitment that Lufthansa would divest up to 24 slots/day at each of those airports.³³ The General Court found that the Commission had erred in accepting two conditions for these remedies that discouraged bidders and, therefore, did not preserve effective competition at Frankfurt and Munich airports.

First, the Commission erred in accepting a procedure for the divestment of the slots that, during the first phase, gave preference to new entrants and excluded Lufthansa's closest competitors from bidding, *i.e.*, airlines that already had a base at Frankfurt and Munich airports, such as Ryanair, Wizzair or easyJet.³⁴ The General Court observed that the Commission failed to justify how the exclusion of Lufthansa's closest competitors could contribute to

maintaining effective competition at Frankfurt and Munich airports.³⁵

Second, the Commission erred in accepting commitments that required remuneration for the divestiture of the slots.³⁶ The General Court upheld Condor's argument that the Commission had failed to explain why the commitments required potential acquirers to pay for the slots, instead of requiring their transfer free of charge, as foreseen by Article 8(b) of Regulation No 95/93.³⁷

VI. Concluding Remarks

The Lufthansa and SAS judgments mark the first time that the General Court has annulled Commission decisions clearing recapitalization measures adopted during the COVID-19 pandemic. In so doing, the General Court clarified the legal standard that the Commission must apply when assessing the compatibility of recapitalization measures with the different requirements set out in Section 3.11 TF. As a result, it is likely that the Lufthansa and SAS Judgments will influence the outcome of comparable recapitalization cases pending before the General Court.

In the judgments, the General Court relied both on the economic and financial evidence presented by the Commission in its decisions and by the applicants, notably when assessing (i) whether Lufthansa had enough collateral to access alternative financing on the markets; (ii) whether the Lufthansa and SAS Decisions complied with the remuneration and step-up mechanisms of the TF, depending on the particular risk profile (debt *versus* equity) of the various financial instruments; (iii) Lufthansa's SMP at the relevant airports, reviewing the completeness of the parameters that the Commission relied on and the consistency of its assessment across airports; and (iv) whether each of the conditions attached to the

overnight parking stands for the aircraft; and (iv) relevant staff (cabin/cockpit) to operate the bases.

³¹ Lufthansa Judgment, paras. 394-395.

³² Lufthansa Judgment, paras. 396-412.

³³ Lufthansa Decision, paras. 71 and 220-230. In addition, Germany committed that, upon request of the purchasers, Lufthansa would make available to the purchasers: (i) additional assets as required by the Slot Coordinator to allow a transfer of those slots; (ii) access to the airport infrastructure or facilities, on the same terms as those granted to Lufthansa by the airport managers; (iii)

³⁴ Lufthansa Judgment, paras. 467-480.

³⁵ Lufthansa Judgment, paras. 472-476.

³⁶ Lufthansa Judgment, paras. 494-503.

³⁷ 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. 1-6.

divestment of the slots in the Lufthansa Decision contributed to or discouraged effective competition.

The General Court also reiterated the importance for the Commission to stick to its own guidelines (here, the TF) when assessing COVID-19 aid, or to provide credible explanations for any departure from such guidelines (which should remain exceptional), in line with the established case law of the Court of Justice.³⁸

The Lufthansa and SAS Judgments add to the list of three annulments by the General Court of Commission decisions clearing COVID-19 aid measures in the TAP,³⁹ Condor⁴⁰ and KLM⁴¹ cases. On May 25, 2023, shortly after the Lufthansa and SAS Judgments, the General Court annulled a sixth Commission decision clearing a COVID-19 aid measure, consisting of an EUR 130 million aid scheme granted by Italy to air carriers with an Italian operating license.⁴²

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³⁸ *Kotnik and Others* (Case C-526/14) EU:C:2016:570.

³⁹ *Ryanair v Commission (TAP; Covid-19)* (Case T-465/20) EU:T:2021:284.

⁴⁰ *Ryanair v Commission (Condor; Covid-19)* (Case T-665/20) EU:T:2021:344.

⁴¹ *Ryanair v Commission (KLM; Covid-19)* Case T-643/20) EU:T:2021:286.

⁴² *Ryanair v Commission (Italian Aid Scheme; Covid-19)* (Case T-268/21) EU:T:2023:279. For additional details on the annulment, please refer to the news piece available here: <https://www.clearygottlieb.com/news-and-insights/news-listing/ryanair-secures-appeal-against-aid-scheme-for-italian-airlines>.