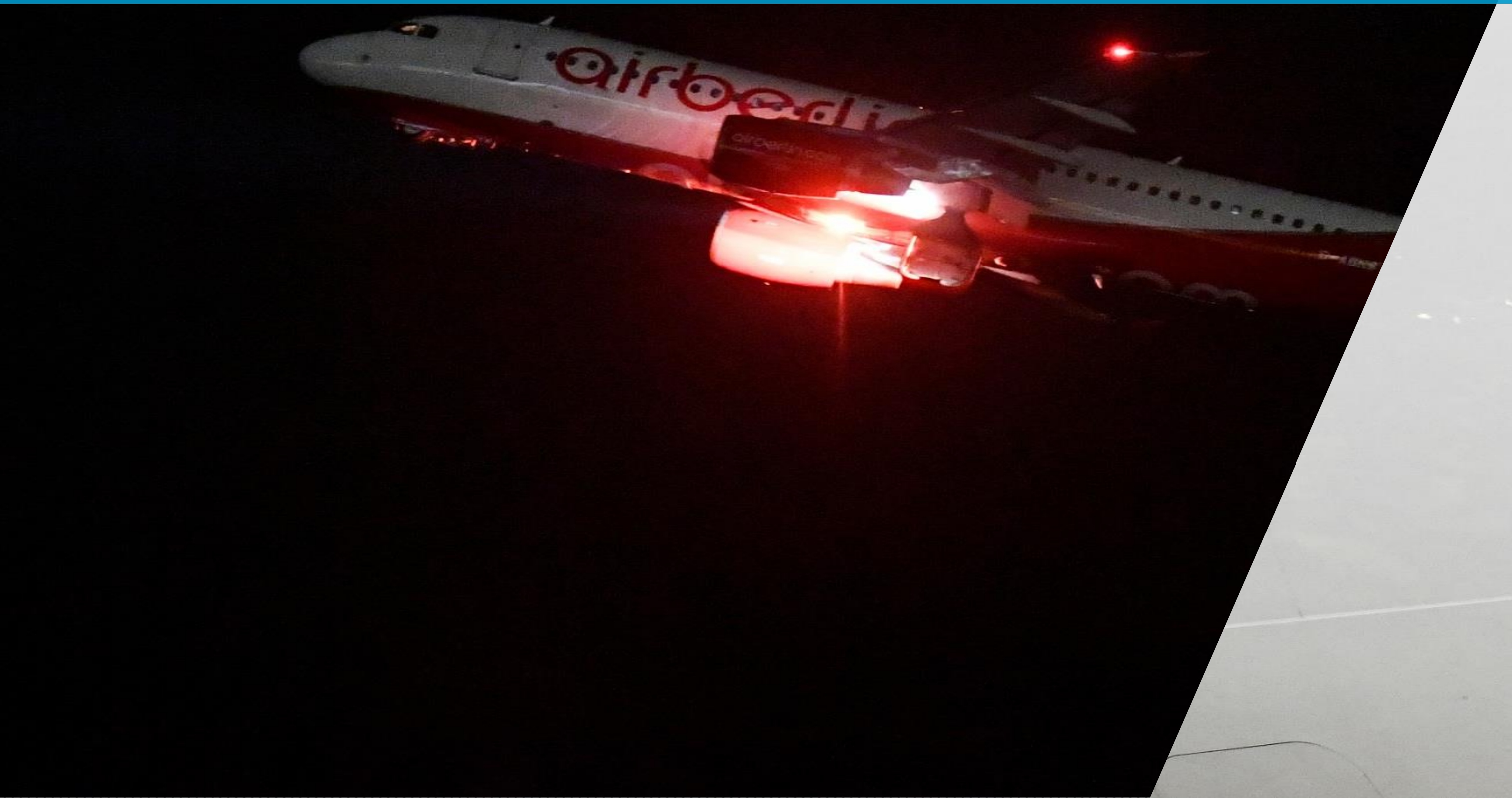
Airline Insolvencies

Recent cases from the UK, Italy and Germany
Case study: Air Berlin says goodbye (Tschüss)

Under Chatham House Rule

Michael Tegethoff, WALA Conference, London, 17 October 2018



Why are we interested in this case?

- Air Berlin was second largest German airline
  - Munich Airport's second most valuable client (just under EUR 100 million turnover in 2016)
- Competition
  - Air Berlin's European market share in 2017: 11%
  - German market share: 25% (Lufthansa 74%)
- State aid
  - Upon filing for insolvency, Air Berlin received immediate loan by KfW (German development bank) of EUR 150 million

Outline

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Introduction: airline insolvencies

Airline insolvencies

Legal framework and consequences

- Insolvency law – Member states' national laws (but incl. Regulation 848/2015 (EU) on insolvency proceedings)
- National insolvency rules are affected by Regulation (EC) 1008/2008 on common rules for the operation of air services in the Community
  - Art. 3 (1): *No undertaking established in the Community shall be permitted to carry by air passengers […] for remuneration […] unless it has been granted the appropriate operating licence.*
  - Competent authority: Member State of registration
  - Various rules regarding economic viability of the airline and the possibility of the authority to assess the financial performance of the carrier at any time
  - Audited accounts must be handed in within 6 months each year
  - If economic vitality is at risk the operating licence is revoked immediately
  - Usual procedure: The airline is grounded

Facts of the Air Berlin case

Company history of Air Berlin (1/2)

- 1978: Incorporation
- 1991: Take-over by J. Hunold (prior LTU manager)
- 2003: Air Berlin becomes second largest German airline
- 2004-2011: Take-overs of several airlines: Niki, dba, LTU, Belair, LGW
- 2008: First major austerity programme
- 2011: Etihad appears as White Knight, eventually holds 29% of shares; majority is in free float
- 2016: Record losses of EUR 447 million

Company history of Air Berlin (2/2)

- 2017, January: Wet lease agreement with Lufthansa reg. 40 aircraft, approved by German antitrust authority
- February: New group head appointed: Thomas Winkelmann (former Germanwings and Lufthansa Munich boss)
- April: New record loss of EUR 782 million
- August 11th: Etihad announces no further financial support for Air Berlin
- August 15th: Air Berlin files for administration
- October 27th (end of summer flight schedule):

  Cessation of all flight operations

The German solution

The German solution (1/5)

… with a bit of help by the European Commission

Possible preliminary considerations by airline at risk of going under:

- The administrator will examine the commercial exploitability of the company's assets and collect the proceeds for the insolvency estate.
- One of the most valuable assets is an airline's operating licence (to which, indirectly, i.a. slots are attached). Slots are not openly tradeable in Germany despite art. 8a(1) of Regulation (EEC) 95/93
- Operating licence requires persona
  and good repute (art. 7 of Regulat
  1008/2008)
- Operating licence is not transfera
  private agreement
- The administrator could not comme
  exploit the operating licence as
- Economic goal: avoid grounding!

The German solution (2/5)

… with a bit of help by the European Commission

How to avoid grounding?

Step 1: Ascertain maximum use of operating licence by insolvent airline

Step 2: Ensure (sufficiently) positive economic outlook for airline to do its business

For step 1:

- Attempt at a balanced approach: limit the airline's power of disposition and of administering its own affairs only
- Apply for self-administration (debtor-in-possession regime as per § et seq. of the German Insolvency Act acknowledged by Regulation 848/2015)
  - If creditors' (preliminary) represe do not object to self-administratio
  - Appointment of creditor trustee (administrator/*Sachwalter*)
  - Air Berlin: appointment of insolver as new board member

A historic view: Air Berlin aircraft at Munich Airport Terminal 1

The German solution (3/5)

… with a bit of help by the European Commission

- **For step 2:** Ascertain positive economic outlook for airline to do its business
  - Art. 9(1) of Reg. 1008/2008: temporary licence possible ≤ 12 months („realistic prospect of a satisfactory financial reconstruction within that period" required)
  - Loan provided: EUR 150 million by KfW for 3 mont
- **Problem:** Article 107(1) TFEU – illegal Stat

Save as otherwise provided in the Treaties, any aid grante by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competi by favouring certain undertakings or the production of cer goods shall, in so far as it affects trade between Member be incompatible with the internal market. […]

  - Aid granted by Member State? (+) KfW is held by the German state
  - Advantage to recipient? (+) limited freedom to dispose of additional EUR 150 million
  - Selective advantage? (+) Air Berlin is sole beneficiary
  - Distortion of competition and trade between Member States affected? (+) Air Berlin is in direct competition with other EU airlines

The German solution (4/5)

... with a bit of help by the European Commission

- Lawfulness of the aid?
  - Loan notified to Commission pursuant to art. 108(3) TFEU (+)
    → Commission investigates and renders Decision SA.48937 C(2017) 6080 final
  - Stand-still obligation observed, art. 108(3) TFEU (+)
- Compatibility of the aid? Art. 107(3)(c) TFEU → Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (R&R Guidelines, OJ C249, 31-07-2014)
  - Eligibility? (+) More than half of subscribed capital has disappeared and due to over-indebtedness company is subject to insolvency proceedings
  - Objective of common interest? (+) Prevention of disorderly transition and hardship for more than 7,000 employees
  - Social hardship or market failure? (+) Up to 4 million PAX booked flights, competitors cannot step in by short notice, seat occupancy rates are high during holiday season
  - Risk of disruption to important service?
    (+) Serious disturbance of transport services

The German solution (5/5)

… with a bit of help by the European Commission

Further arguments considered by the Commission	Reality check
Air Berlin passengers (voters) should be returned in time for the general elections in September 2017	How many voters would have been away on that particular day? Only a fraction of the alleged 2-4 million PAX. Consider absentee voting?
Slots would be lost (here: transferability pursuant to art. 8a (iii) of EU Regulation 93/1995)	Slots were attached to the LGW take-over by Lufthansa as well as the Niki take-over by Niki Lauda; easyJet was most likely granted additional slots for its purchase of some aircraft; the remainder was returned to the pool
Competitors criticized that only major airlines would be able to compete for parts of Air Berlin and receive valuable slots; Commission said everyone could be bidder for assets of Air Berlin	All airlines would have received the chance to apply for slots to the national coordinator; in fact, Lufthansa, Niki (Ryanair) and easyJet received most interesting slots; only a small fraction was returned to the pool
Germany must ensure repayment of EUR 150 million loan	18.0 million - Lufthansa 40.0 million - easyJet 17.0 million - additional asset sales <u> 2.3 million - early termination of Winkelmann</u> **77.3 million in total** (figures according to airliners.de, 16 August 2018)

The role of German politics

Some quotes

- Federal Minister of Transport, Mr. Alexander Dobrindt (CSU)

  *We need a German champion in the international air transport industry. Therefore, it is urgently required for Lufthansa to take over substantial parts of Air Berlin.**
  (FAZ, 17 August 2017)

- Federal Minister of Economy, Mrs. Brigitte Zypries (SPD)

  *I would appreciate if Lufthansa took over major chunks of Air Berlin.**
  (Stuttgarter Nachrichten, 21 August 2017)

- Federal Secretary of State for Economy, Mr. Matthias Machnig (SPD)

  *What we don't need is airlines operating with false self-employment and wage dumping.**
  (Die Welt, 17 August 2017)

* Translations by the speaker

One year later…

One year later

Competition is rare*

- Market share (national routes) summer 2017
  - Lufthansa 74%
  - Air Berlin 25%
- Market share (national routes) summer 2018
  - Lufthansa (incl. Eurowings) 87%
  - easyJet 8%
  - 6 other airlines combined 5%
- Of 122 national routes
  - 94 are served only by Lufthansa Group
  - 18 are served only by one other carrier
  - Only 10 are served by multiple airlines in direct competition

* All figures: DLR Transport Research at https://www.dlr.de/dlr/presse/Portaldata/1/Resources/documents/2018/DLR_Touristik_2018_.pdf

Thank you

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