

The Malév Story

Saturday, 11 May 2013

March 1: update to the story (last section)

Upon Malév's announcement of its bankruptcy on February 3, it was hard not to feel like being caught in an emergency drill. The future holds other, much more challenging defaults for the Hungarian people; air travel is too luxurious and its impact is too limited for the Malév failure to count for anything more than a practice round. Bets are either on BKV, the municipal transportation system in Budapest, or on MÁV, the Hungarian State Railway, but various municipal councils may also be the next to follow suit. These do not have business rivals to step into the void they leave behind, the next Hungarian bankruptcy story is therefore more likely to hold real dramatic potential. Which is not to say that the leaders of the country did not exploit the loss of the national airline for their political pursuing their goals, no matter how easy or difficult these losses would or could have been to avoid.

Febr. 3: Airplanes Are Grounded. Budapest's Liszt Ferenc Airport received news at 5 a.m. that Malév would never ever take off from its grounds again. Officially the company kept its fleet grounded starting at 6 a.m., but passengers waiting to depart were not given the information until 7 a.m. But why was Malév still selling tickets as late as Thursday night, just hours before announcing that it is incapable to honor them?

On Thursday, Malév was placed into bankruptcy protection in order to assure its operations, but the situation has taken an abrupt turn during the night; we learnt on the same morning. Malév pilots were already carrying bags of cash to pay for their aircraft's servicing before their return flight to Hungary. Malév, however, also owed commission fees to IATA, the international organization of ticketing agents, and a lump payment of 30 million euros came due on Friday. Two planes from the company's leased fleet were grounded at the Tel Aviv and Dublin airports because of the missed payment. Letting planes depart from Budapest would have meant risking payment of further debts in exchange for any aircraft kept behind at other destinations by the company's creditors.

To use the Hungarian saying, Malév waited until the candle burnt onto its nail. According to numbers from February 3, the airline's debts totaled \$270 million. In 2010, the company reported a loss of 24.6 billion forints (\$110 million), close to the same deficit it reported for 2009. To prop up its operation, the airline received state support from the government at least twice in 2011: first an 8.5 billion HUF contribution from the state budget in August and in December a loan of 5 billion HUF. 2600 employees of Malév are expected to be out of job once the bankruptcy of the company is finalized. Though they could find employment with rival company, as the job fairs held this week already made clear, only at the cost of relocating and losing their seniority could they continue to work in their professions.

Populist Economics. In Hungary, it does not take long before technical decisions requiring specialized expertise and access to business information become fodder for political rhetoric. That the Malév story was seized upon as a political opportunity by the government which was supposed to stand watch over avoiding its bankruptcy might sound strange to those not familiar with the culture of polarization in Hungarian politics. But since Malév has been known to be a poor performer for a long time, the fact that previous government become implicated in the story is also not entirely unexpected.

By Tuesday, February 7, Malév featured as a crucial rhetorical element in Prime Minister Viktor Orbán's "state of the country" speech. At the level at which the story was engaged to justify the government policies in general, the Malév story does indeed fit with the narrative on which the current Hungarian government bases its popular appeal. As this simplified version of the story goes, previous governments (and most especially the Socialist government leading the country between 2002-2009) were spendthrift and irresponsible. They drove up the country's debt and brought about untenable circumstances for Hungary. Against these impossible conditions, the Orbán government must fight with any method available, but regardless of their herculean efforts, there will be many more reminders of the evil prior to their government in the form of future problems in the country.

The particular tragedy of this narrative is that it is in part based in reality, and that, as many things in part based in reality, they might be believable in their entirety, even to the extent that they are delusional. The previous socialist government were spendthrift, and on several occasions their politicians drew personal benefit from the squandering of public money. The story unfolding in the wake of Malév's bankruptcy, however, is a populist search for a scapegoat: it is a search for cheap conclusions and easy-to-understand narratives behind complex economic policies and business decisions.

Wizzair's József Váradi. But if one thing is certain, it is that the story of the Hungarian national airline does not allow for easy conclusions. The person who stands to benefit the most from Malév's default is József Váradi, chief executive officer of Wizzair, a low cost airline company that still operates out of the Budapest airport. Váradi used to serve as Malév's chief executive, until he was dismissed by the socialist government in 2003, allegedly for

mismanaging the company. It was on the basis of Váradi's complaint (his airline, Wizzair, stood to lose directly from the unfair competition of the national airline) that the European Commission looked into state funds propping up Malév's operations. Váradi knew about the benefits of the arrangement: Malév utilized the same method of funding while he was its director too, though back then Hungary was not yet a member of the EU.

Because he was appointed to the company while the country was under Fidesz governance – in July 2001, during Viktor Orbán's first term – Váradi is often considered to be Orbán's man, though the facts hardly seem to support a strong connection. The Orbán government would certainly dispute this characterization: they blame Váradi among other things for causing the end of Malév by "betraying" the airline to the European Commission.

The European Commission's Verdict. On January 9, 2012, upon the examination of subsidies received by Malév from the Hungarian state between 2007 and 2010, the European Commission determined that \$390 million of aid received by the company constituted illegal state aid.

Several things that have been written about this development do not really follow from what was stated in the European Commission's verdict. Most importantly, the verdict did not really "seal the fate" of the airline. The door was still left open to restructuring the company: not of course in the way in which this option is still on the table, which is unlikely to lead to the revival of the company, but along the lines of what is sometimes called the smooth transition plan. Such a transition plan was collectively agreed upon both by the caretaker government of 2009-2010 and representatives of the currently governing party. It had been drawn up and awaiting execution by the current government in 2010, but it presupposed a restructuring before that proverbial candle really burnt upon the company's nails. On this option, Malév would have started operating within hours after it announced its bankruptcy, well before its rivals were able to take advantage of the company's lost business.

It also does not directly follow from anything stated in the verdict issued by the European Commission that any of the Hungarian governments were incompetent and/or ignorant for supplying these funds to Malév, though accusations along these lines were made on both sides in the dispute I am soon to describe below. The European Commission would not have automatically regarded every single forint that comes from the Hungarian government as "illegal state aid"; in particular, the Hungarian government could have provided funds as part of the above "smooth transition plan" – without being found in violation of EU laws.

"Strategic" Assets. Why was such a restructuring never completed? Either the Hungarian government never intended to save Malév from bankruptcy, or it never got around to it. Would it have been wise to save the company? To be sure, what remains to be saved is not much. The fleet in use by the airline was leased, a considerable proportion of the passenger traffic was recruited by reduced-priced tickets – subsidized, in effect, by the Hungarian tax-payers. Many of the assets of the company have already been used up, they were sacrificed whenever immediate stopgaps were needed in spite of the fact that their loss only contributed to running up further debts. The three assets usually mentioned in this regard are the company's share in the Hyatt Regency hotel, the Budapest Airport's oil refill facility and the Heathrow slot.

Malév used to own 50% of the Hyatt Regency, which also housed its business offices. The company's directors decided to sell these shares in 2001, even though henceforth the company had to pay rent for its new offices. In 2005, the company paid its debt to the company operating the Budapest Airport by transferring to them their kerosene refill facility. And in 2006, the airline received 2 billion HUF (\$9.1 million) from British Airlines for a "slot" for operating at Heathrow Airport. It has been flying out of Gatwick since then.

Malév's Management. The overall strategy of the directors of the company thus seemed to have been survival until the upcoming day, even if their decisions made the operations of the company much more difficult for the future. This was due to the fact that many of the company's chief executive officers did not last long in the position: the political culture, which rewarded family members and close friends of politicians in the government by cushy and profitable jobs (preferably with minimal responsibility, e.g. a seat on the board of directors) required a quick turn-over.

The earliest of scandals specific to Malév dates back to at least 1998, to the appointment of the daughter-in-law of József Torgyán, a right-wing populist politician serving as the minister of agriculture for the (first) Orbán government. Mrs. Beatrix Hingyi had no credentials relevant to managing an airline besides being descended from a "family of aviators" and having pursued a career as a ticketing agent. Neither was the public outrage over the appointment considered important enough for the government to backtrack on the appointment. The feudal awards at Malév continued ever since, during the socialist government as much as during the current regime. Since its privatization in 1992, Malév had 16 different chief executive officers – sixteen different business strategies, in effect. Many of these set out to follow boldly different business plans from plans projected by predecessors and/or to erase any business success which may have validated the decisions of the appointees of the rival political alliance.

The Price Tag Attached. The assets squandered away by the directors of the company are insignificant, however, compared to the loss potentially ascribable to various politicians in the wake of Malév's default. As announced on

Wednesday by Gyula Budai, the Hungarian government's special commissioner for accountability, a secret clause of the privatization contract of the Budapest airport mandates the Hungarian government to pay 1000 billion HUF (about \$4.6 billion) to Hochtief, the German company which holds a 50% ownership share in the airport, in case the Hungarian airline fails to continue operating from the airport. Budai had already initiated a criminal investigation into the privatization of the airport last September, regarding other circumstances of the privatization – against an "unknown perpetrator" in relation to charges of financial negligence. Given his new discovery, he now recommends a parliamentary investigation.

Earlier during the week, the dispute concerned 1000 billion HUF, toward the end of the week, the number used by both parties was 800 billion HUF, or \$3.6 billion. The political stakes seem to be even more important, however, to both sides. "The previous government has proven unequivocally that it represents not the interests of the Hungarian state, but those of foreign investors. Had either the Gyurcsány or the Bajnai governments represented the interests of the Hungarian state, such a contract, ladies and gentlemen, would not have come about," said Mr. Budai on Wednesday at his press conference. "Mr. Budai has lost his mind," responded Ferenc Gyurcsány. "It is a shocking instance of political and economic irresponsibility that, even if there were an interpretation of the contract according to which the Hungarian government were to be responsible for indemnities, it is one of the Hungarian government's people who would supply further fuel to these claims."

Asked immediately after Budai's bombshell announcement, prime minister Ferenc Gyurcsány and finance minister János Veres, both from the government that initiated the privatization of the airport, could not recall the clause. Péter Oszkó, the finance minister of the care-taker government between 2009-2010 also questioned the amount mentioned by Budai (it is twice the amount paid for the airport's privatization, an "addition mistake") as well as Budai's interpretation of the clause (because reparations would only be due to Hochtief if the airport's traffic dropped considerably as a result of Malév's failure). Oszkó thus far has been very efficient in countering Budai's claims, this week, however, an internet portal broke the news that he sits on rival airline company Wizzair's board of directors.

Media investigations released independent of and prior to the scandal support Oszkó's claims: both the economic weekly HVG and several of the opposition and the business newspapers are essentially in agreement with Oszkó's facts. As they point out, the 1000 billion HUF (or, in later versions, the 800 billion) is the maximum amount of reparations a court would award on the basis of the contract. It would become payable to Hochtief only if they indeed seek reparations for the loss of traffic (other airlines have picked up much of the business to and from Budapest since). If the German owner of the airport did decide to activate the clause, however, they could pull out of their privatization contract: the government would in effect be buying up their shares to the extent determined (likely a function of the traffic lost at the airport, perhaps by a court, though interpretations differ on this point).

Whether the "secret" clause was ever secret is also being disputed. According to Ferenc Gyurcsány, the contract was shared with representatives of every parliamentary party; that Fidesz has been aware of it all this time is also supported by references to reparations to be paid to the company operating the Budapest airport in the so-called White Book, the current government's pamphlet prepared last year on the situation of Malév (though the reference is to a different number, and potentially a different clause of the contract). If this is true, the "secret" clause might not be so secret after all, though in an important respect it is too secret: the contract has not been made available to the press. On Friday of this week, an internet portal has taken Budai to court over his refusal of the media outlet's freedom of information request for an actual copy of the contract.

If Budai's interpretation bears out, the government's obligations and the government fails to restart the Hungarian airline, the amount to be paid by the Hungarian government for nationalizing the airport would be twice the government's 2012 deficit. The high number is due in part to the fact that the Budapest Airport's privatization was too high: according to analysts, the amount paid was three times what it might be worth today. In the meantime, news of the "secret" clause prompted the IMF to consider a downward revision to Hungary's 2012 growth forecast.

The Minister in Charge. The minister in charge of transportation matters in Hungary was conspicuously absent during this entire crisis. "There is an emergency team set up in the ministry" for handling the fallout of Malév's bankruptcy, the minister's press surrogate, state secretary Pál Völner stated last Friday. During the highly charged political disputes and while government officers remain in negotiations with the owners of the Budapest Airport, she was neither seen nor heard from on the matter.

Németh Lászlóné, née Zsuzsanna Serényi, became the Minister of National Development in December 2011, shortly after the resignation of Tamás Fellegi from the same position. Mr. Fellegi resigned the position after he had been appointed as Hungary's chief negotiator of the 15-20 billion euro's worth of IMF loan that Hungary has been trying to secure since November 2011.

Mrs. Németh's ministry, the Hungarian Ministry of National Development is responsible for obtaining and distributing funds for developing the Hungarian economy, including Hungary's EU cohesion funds – 570

billion Hungarian forints (\$2.6 billion) just this year. State assets are also under her supervision, as is the transportation sector in general, whether state-owned or private. 95% of Malév were owned by the government, though recently the trend to nationalize companies of “strategic” importance, along with the responsibilities of Mrs. Németh’s ministry, have picked up: the current Hungarian government owns 21,2% of Mol, the majority of the shares in Rába, a truck factory and just recently, the Hungarian Postal Service and the state’s development bank won a tender to operate a mobile communications company.

The issue of her credentials and notable gaffes notwithstanding (during her appointment hearing, she addressed a parliamentary committee as the “honorable court”), there is no reason to doubt that Mrs. Németh is busy providing ministerial oversight to the distribution of the above funds and the management of the aforementioned assets. On the other hand, the evidence that she is anything more than a minister in name only is also scarce. Since her appointment in December, her ministry has been undergoing a transition to the so-called “communications model”: beyond statements necessary for her appointment, which she read from her prepared remarks, Mrs. Németh has not made any public appearances where the press could have asked questions from her. According to press reports, she plans to rely on a team of public relations specialists to serve as the public face of the ministry in the future, too.

Also known about Mrs. Németh’s team is that she appointed Attila Nyerges, a veterinary doctor, as her chief political advisor. Little is known about Mr. Nyerges’ qualifications for the job, though the fact that he is the brother of Zsolt Nyerges, an entrepreneur and business partner of Lajos Simicska is notable. Simicska’s role and significance for the Hungarian governing party eludes precise characterization: supposedly he is the top person to hold together the business interests lined up behind the governing party. While the ministry was undergoing this transition, most of the communication about Malév’s default was left to the airline’s personnel, such as Lóránt Limburger, the current chief executive officer of the airline and János Berényi, its chairman. The ministry’s was only represented at the state secretary level, by Pál Völner – until Budai’s allegations about the airport’s privatization took away the limelight from the failure of the airline company.

Hungarian Air Force One? Malév has returned its leased fleet to the Ireland site of the American company ILFC, yet two aircrafts from purchases prior to 2003 remain in the company’s possession. One of these is a heavily liened Boeing 767 which could not be resold once the company’s business strategy no longer required an aircraft of its size. The Hungarian government has long fixed its eyes on the other one, a 48-seat Bombardier CRJ 200. The Malév Bombardier CRJ 200 that may become the Hungarian government's plane for official travel.

Already in the beginning of 2011, when Hungary was serving in the role of the president of the Council of the European Union, various options were entertained about how best to economize the travel needs of country’s politician. At that time, even the idea of leasing a company jet was entertained as an option, and the existence of the plane – originally one of four similar planes, of which only three was able to find a new owner since 2003 – appeared more cost-effective. Now that the company is in bankruptcy, bets are on the Hungarian government finally availing itself to the opportunity of creating a Hungarian version of the American president’s Air Force One.

Update to the story: Following Budai’s discovery of a secret clause, there were many reports about intense negotiations between the Hungarian government and Hochtief about minimizing the price tag supposedly attached to Malév’s bankruptcy (especially in Hungarian, but in international business news as well, see for example Reuter’s “Hungary Seeks To Limit Malev Budget Impact“).

As it turns out, the secret clause was merely a figment of Budai’s imagination. This has only been proven by a leak of the contract weeks after the scandal has already dies down. The closest any text comes to the bombshell clause Budai has quoted to reporters at a press conference has to do with an arrangement regarding the bankruptcy of the Budapest Airport. Nothing of the sort that Budai read from the contract may be found in the actual document.

Budai, nevertheless, is to be duly rewarded for his services to the government: in late February, he was appointed an undersecretary in Hungary’s Ministry for Rural Development. The Contrarian Hungarian