II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 27 July 1994

concerning the notified capital increase of Air France

(Only the French text is authentic)

(Text with EEA relevance)

(94/653/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having regard to the Agreement establishing the European Economic Area, and in particular point (a) of Article 62 (1) thereof and Protocol 27 thereto,

Having, in accordance with Article 93 of the Treaty, given notice to the parties concerned to submit their comments and having regard to those comments,

Whereas :

I

By letter of 18 March 1994, registered with the Commission on 22 March 1994, the French authorities notified the Commission, pursuant to Article 93 (3) of the Treaty, of their plan to inject capital of FF 20 billion into Compagnie Nationale Air France. The French authorities enclosed with the notification a restructuring plan called 'Projet pour l'Entreprise' (hereinafter referred to as 'the Plan'). On 12 April 1994 Directorate-General VII (Transport) of the Commission held a meeting in Brussels with representatives of Air France and the French Government. During this meeting the French officials provided the Commission with additional information and a letter in reply to the Commission's letter of 28 March 1994. The aid was registered as notified aid with the Commission Secretariat-General and was attributed the number N 258/94.

The Commission decided to open the Article 93 (2) procedure with regard to this aid and informed the French authorities of its decision by letter of 30 May 1994. This letter was published in the *Official Journal of the European Communities*(1) and third parties were invited to comment within one month from its publication.

The French authorities replied to the Commission's letter by a letter of 14 June 1994, and by subsequent letters. Further information and comments were then submitted in writing and during several meetings held in Brussels between the Directorate-General VII (Transport) of the Commission and representatives of Air France and the French Government.

The United Kingdom, the Netherlands, Ireland, Norway, Sweden and a large number of private parties, and in particular European airlines, among which British Airways, TAT, AOM, British Midland and the ACE ('Association des compagnies aériennes de la CE'), submitted comments on the case. The comments were duly transmitted to the French authorities, who replied to them by letter submitted to relevant services of the Commission.

II

The Air France group, as it is known today, was set up on 12 January 1990, when Air France took over UTA and thus acquired indirect control of Air Inter, the air carrier

(1) OJ No C 152, 3. 6. 1994, p. 2.

operating the majority of the French domestic routes, of whose capital Air France already held 36,5 %. Air France and UTA merged on 29 December 1992 and the new company was called 'Compagnie nationale Air France' (hereinafter referred to as 'CNAF'). As a consequence of the merger, CNAF now directly holds 75,84 % of Air Inter's capital. Whilst the Air France group carries out air transport operations and hotel, leisure travel, catering, maintenance and pilot training activities, air transport is by far its main business activity (the turnover of the air transport sector represented in 1992 79,5 % of the total turnover of the group).

Together with British Airways and Lufthansa, the Air France group is one of the three biggest European air carriers. As of 31 December 1993 the group's turnover was FF 55,156 billion (by way of comparison, in 1992 the Air France group's turnover was FF 57,013 billion, i.e. ECU 8,664 billion, that of British Airways was ECU 7,323 billion and that of Lufthansa was ECU 8,909 billion) and it employed about 64 000 people (as of 31 December 1993 Air France alone employed 39 956 people : 30 606 ground personnel, 2 925 technical flying staff and 6 425 commercial flying staff).

Since the beginning of the 1990s the Air France group has been pursuing a strategy of enlargement aimed at safeguarding its influence on the domestic market, preparing itself for the future liberalization of the Community aviation market as well as for competition on other international routes. Besides the acquisition of UTA, and indirectly of Air Inter, CNAF took, in April 1992, a 37,5 % shareholding in the capital of the Belgian carrier Sabena and in March 1992 it acquired a 20 % shareholding in the Czech airline CSA; the latter participation has however recently been dissolved. On the international side the Air France group began a policy of modernization and expansion of its fleet. The acquisition of new aircraft was financed through borrowings, on which financial charges negatively affected the group's final result. This posted a first loss of FF 717,2 million in 1990. To face this situation and adapt its financial structure and costs to the new economic environment which was characterized by a severe recession following the Gulf crisis, increased competition in particular on the north Atlantic, as well as the liberalization process within the Community, the Air France group launched a strategic plan (known as CAP '93) in September 1991.

This plan provided for a reduction of some 3 500 jobs during the period 1991 to 1993 and an initial recapitalization of the airline amounting to FF 5,8 billion to be realized in three tranches (capital increase and two bond issues). The Commission assessed these capital injections under the State aid rules of the Treaty in its two decisions of November 1991 and July 1992 (Case Nos N 653/91 and N 291/91). In these decisions the Commission took note of the Air France group's financial problems and the deterioration of the airline's structure between 1988 and 1991. However, the Commission considered at that time that the airline was facing a temporary crisis and that, despite some short-term problems, the long-term prospects and the overall structure of the Air France group appeared relatively good. The financial injections were, therefore, considered to be normal financial transactions and not State aid. In October 1992, having taken note of a further deterioration of the company's financial structure and operating performance, the Air France group's board of directors adopted a second restructuring plan (the 'Plan de retour à l'équilibre'), hereinafter referred to as 'the PRE1'). The PRE1 aimed to increase the Air France group's cash flow by FF 3 billion each year through the adoption of a number of measures to reduce operating costs (including a further planned reduction of 1 500 jobs). During the first months of 1993 the PRE1 showed its insufficiency to redress the situation of the Air France group, which continued to make losses and to lose market share. The PRE1 was then abandoned and in September 1993 the Air France group's board of directors launched a third restructuring plan (hereinafter referred to as 'the PRE2') providing for 4 000 job cuts and suppression of a certain number of routes. The PRE2 aimed at improving cash flow by FF 3,4 billion in 1994 and FF 5,1 billion from 1995 on. The PRE2 was rejected by the unions who went on strike at the end of October 1993. The new board of directors of the Air France group withdrew the PRE2 and drew up the Plan, after sending the staff a questionnaire asking them for their ideas.

The Air France group is at present facing a very serious financial and economic crisis. After a FF 3,2 billion loss in 1992, it made its fourth consecutive annual loss amounting to FF 8,4 billion in 1993 (the net loss for CNAF alone was FF 6,7 billion, according to the accounts published on 17 June 1994). In the last three years the group's situation has constantly deteriorated and reached its nadir in 1993 when the group made an operating loss of FF 3,3 billion, after an operating profit of FF 213 million and an operating loss of FF 1,5 billion in 1991 and 1992 respectively. In 1993 CNAF's operating losses (FF 3,6 billion) increased by 295 % over the 1992 operating losses (FF 918 million). The airline's cash flow has steadily deteriorated while net financial charges have recorded a substantial increase. The group's recent financial performance has been worse than that of its major competitors.

The group's accumulated losses, which result from poor operating margins and the heavy financial charges, have eroded the equity of the group. The group's debt position in 1992, even after the recapitalization carried out pursuant to the restructuring plan, was still unsatisfactory.

The group's gearing ratio (total debt/equity ratio, provisions excluded) was, in 1992, slightly worse than that of its major competitors who had not embarked on similar recapitalization programmes.

The gap between the Air France group and its competitors has increased because of the bad result of 1993 which severely affected its own capital.

Besides the substantial financial charges, the bad results of the group are due mainly to its poor productivity and high operating costs.

As a consequence of the restructuring efforts, and particularly the staff reduction (in total, staff was reduced by some 4 000 people in 1991 to 1993), the group has improved its productivity ratios in 1993 : the available seat kilometre/employee ratio was 1 590 for the airline and 1 617 for the group as a whole. However, the group is still over-staffed and appears to be in need of a major reduction in personnel to achieve the productivity levels of its competitors, who have already started major cost-reduction programmes (e.g. Lufthansa).

Another factor with affects the group's operating performance is its fleet mix. The fleet consists of too many different types of aircraft (CNAF operates 24 different types or versions) and this contributes to the airline's high operating costs (e.g. high maintenance costs caused by the large number of different spare parts and different qualifications of the flying and ground personnel). As of 31 December 1993 the group's fleet consisted of 208 airplanes (CNAF's operating fleet consisted of 145 airplanes), of an average age of 8,6 years. The number of chapter II aircraft (47) is rather limited. The young age of the fleet is mainly due to the investment and modernization efforts carried out pursuant to the CAP '93 restructuring plan.

The Plan was drawn up by Air France on the basis of a paper drafted by Lazard Frères et Cie (hereinafter referred to as 'the consultants'). The consultants assessed the financial coherence of the assumptions of the scenario 1994 to 1996. On the basis of the data (forecast revenues and costs) provided by CNAF for the restructuring period, the consultants also fixed the amount of recapitalization needed to redress CNAF's financial structure and profitability.

The aim of the Plan is 'to make Air France a real company'. This target should be attained during the period between 1 January 1994 and 31 December 1996. At the end of 1996 CNAF's financial balance and profitability should be restored. The Plan provides for an increase of 30 % in Air France's productivity during the restructuring period. The Plan relates solely to CNAF and leaves aside all the implications of the restructuring measures for the group. Moreover, according to the notification, the capital injection will benefit only CNAF and not the other companies of the group.

In particular the Plan focuses on the following topics :

A. *Reduction in costs and financial expenses*

1. Decrease in investments

The number of new planes to be delivered during the restructuring period is adjusted from 22 to 17 ; the corresponding fleet investment is, at FF 11,5 billion, some 21 % lower than originally planned. It is planned to sell 34 old aircraft (currently in storage). The total fleet will, therefore, be reduced from 166 planes in early 1994 to 149 at the end of 1996. The operating fleet itself (145 airplanes as of 31 December 1993) will be increased by just one plane ; the number of seats offered will be slightly reduced.

2. Reduction of operating costs and adoption of measures to increase productivity.

CNAF intends to reduce its operating purchases (fuel excluded), which amounted to FF 13 billion in 1993, by FF 2 billion during the restructuring period.

Personnel will be reduced by nearly 5 000 people (3 700 ground staff and 1 300 flying staff) through voluntary redundancies (from 39 956 at the end of 1993, to 35 000 at the end of 1996). Wages will be frozen during the restructuring period, but this measure could be re-examined if inflation is higher than the levels assumed (2,2 % in 1994, 2,5 % in 1995, 2,9 % in 1996) or in case of positive financial results. Promotions will be blocked in 1994 and, for the next two years, will depend on the situation of the undertaking. The company expects annual savings of FF 3 billion from these measures. Moreover, the company will adopt measures aimed at a better utilization of work time (reorganization of the company into independent profit centres, see below ; and decentralization of the decision-making process) and will increase work time up to the legal maximum level. The increase in productivity expected from the implementation of these measures is some 12 %.

3. Decrease in financial charges

As a consequence of the timing and the amount of the capital increase, financial expenses will be greatly reduced (from FF 3,2 billion in 1993 to FF 1,8 billion in 1996).

B. *Different conception of the product and better utilization of means*

1. Marketing initiatives

In order to adapt to the needs of consumers, who have become more price sensitive, CNAF will simplify its services making them more flexible. In particular, CNAF will offer new products (Euroconcept and Première Club) on the short and long-haul flights respectively.

2. Fleet, programme and yield management

CNAF will rationalize its fleet by reducing the types of aircraft (six types or versions will be removed from the operating fleet).

CNAF will make its programme more stable ; only one type of aircraft will be needed on each long-haul route and the fleets attributed to each regional profit centre (see below) will become more homogeneous ; the routes retained in the network will have to achieve a certain minimum frequency ; multi-stop flights will be reduced. These measures will bring about a reduction in operating costs together with an increase in the average daily utilization of the fleet and staff.

CNAF will simplify its network. CNAF forecasts a relatively weak growth in its European network. CNAF will increase frequencies on the profitable routes, develop long-haul routes (in particular east Europe where CNAF will pursue a policy of operating a minimum number of daily flights), abandon marginal routes and focus on the routes where growth prospectives are good.

The company will use a performance yield management system to increase revenues and load factors and thus increase its profits.

C. *Reorganization of the company*

CNAF will be restructured into 11 operating centres which will be responsible for their own financial results. The air transport activity will be reorganized into six operating centres as of autumn 1994 : one centre will be set up for cargo and five centres with different geographical competence for passenger traffic : Europe and medium-haul destinations, Africa and Near East, North and South America, Asia-Pacific Ocean, Caribbean-Indian Ocean. Each centre will have its own assets, and be in charge of its own production and commercial and management activities. The other centres will be entrusted with activities accessory to air transport : sales, maintenance (two centres), computer and telecommunications, the airports of Paris (Charles de Gaulle and Orly). The financial transactions between the centres will be carried out on the basis of internal prices which will be negotiated once a year.

D. *Participation of employees*

CNAF will distribute free shares to its employees who will be able to increase their shareholding by way of compensation for a voluntary reduction in wages.

The implementation of the plan will be financed through the increase in capital and selling non-core assets. CNAF expects to realize some FF 7 billion from these sell-offs. Regarding the tangible assets, CNAF will dispose mainly of some of its airplanes ; the reduction of the fleet by 17 airplanes will be carried out through acquisitions, sell-offs and expiry of operating lease contracts. Selling-off of aircraft will generate FF 4,1 billion in revenue. Besides the airplanes, CNAF will, *inter alia,* sell-off spare parts (FF 1,2 billion), a building (FF 0,4 billion), as well as the hotel group Meridien.

The French Government notified the Commission of its intention to increase, as the majority shareholder of the airline, CNAF's share capital by FF 20 billion. According to the French authorities :

— the capital increase will be carried out in three tranches : FF 10 billion in 1994, FF 5 billion in 1995 and FF 5 billion in 1996. The first increase in capital will be subscribed after the adoption of the Plan, following an agreement between the unions and the company. The payment of the other two tranches will be subject to effective implementation of the restructuring measures,

— the capital increase will benefit CNAF alone and not the other companies of the group,

— this capital injection will be the last aimed at redressing the airline's situation. The capital injection will be carried out in view of the possible future opening of the capital of CNAF (which is on the list of French undertakings to be privatized) to private investors,

— in case the Commission considers that the capital injection constitutes aid pursuant to Article 92 (1) of the Treaty, the aid might benefit from the derogation provided for pursuant to Article 92 (3) (c) of the Treaty as aid to facilitate the development of certain economic activities. The French Government maintains that the aid is linked to the Plan, which is aimed at redressing the economic and financial balance of the airline within the restructuring period. The aid does not affect trading conditions to an extent

contrary to the common interest. The amount and timing of the recapitalization have been decided by the French Government on the basis of the consultants' conclusions. The recapitalization will reduce the airline's debts to restore its financial balance. The aid will not increase CNAF's capacity to the detriment of its competitors. During the restructuring period the operating fleet will increase by just one airplane and the total number of seats available will slightly decrease. The 8,3 % increase in capacity (measured in available seats kilometre) over the restructuring period will stem from a better utilization of the fleet. Supply on medium-haul routes, which include the Community market, will increase by only 2,8 % and the main increase in supply will concern long-haul traffic (10,2 %). Taking into account the forecast increase in traffic (around 5,5 % p.a. worldwide an 5 % p.a. in Europe) CNAF's market share will decrease. On the other hand, the dissolution of CNAF would have effects contrary to the common interest because it would weaken competition in the European air transport market and the position of the European civil aviation industry relative to the American and Asian ones. CNAF's dissolution would also have catastrophic effects on employment in a period when the European Union is severely affected by unemployment.

III

The Commission opened the Article 93 (2) procedure because it had some doubts on the following points :

1. that the aid and the Plan concentrate exclusively on CNAF, while economic reality requires a restructuring plan to take into account the economic situation and prospects of the whole group. The Commission had to investigate the impact of the aid and the Plan on the results of CNAF and of the group as a whole to verify whether the Plan is sufficient to restore viability ;

2. that the Plan and its sectoral implementation, including the social measures, would be carried out effectively ;

3. that the aid does not adversely affect trading conditions on the routes upon which the airlines belonging to the Air France group compete with other European airlines ;

4. that the aid is not disproportionate to the needs of the restructuring and does not lead to overcapitalization. In this respect, the Commission needed to analyse and assess the nature (equity or debts) of some bonds issued by the group (TSDI, ORA and TSIP) ;

5. that the aid is the last in favour of the group and is not used to acquire additional shareholdings in other Community air carriers ;

6. that the French Government will refrain from interfering in the group's management for other than commercial reasons.

IV

With regard to the comments submitted by the third parties it is worth mentioning that none of them contested the aid character of the planned capital injection in favour of the Air France group. Most of the parties share the Commission's doubts regarding the application of Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement to the aid in question. The main issues raised by the third parties may be summarized as follows :

— the aid is in favour of the group and not only CNAF, which could re-distribute the aid to its subsidiaries. A possible separation of CNAF, from Air Inter and Air Charter, would be artificial because a coordinated commercial strategy would still be possible for all the companies of the group,

— the French authorities did not provide sufficient information on the Plan, in particular regarding the future network,

— the Plan is not sufficient to restore viability within three years given the proposed reduction in costs (in particular with regard to personnel), and in investments, against the background of the continued restructuring efforts by Air France's competitors. In any case, the group would not be allowed to restructure because of the constant interference of the French Government in the management of the company,

— the aid is disproportionate to the needs of the restructuring and will lead to overcapitalization of the group, which will receive a very strong advantage over its competitors. In addition, the group does not need such a large amount of aid as it could finance its restructuring itself through selling-off non-core assets (e.g. Meridien and Servair) or reducing its investment in other companies (e.g. Sabena), postponing fleet investment, or withdrawing from routes which are not profitable,

— the conditions to grant an exemption pursuant to Article 92 (3) (c) are not satisfied because the assessment of the compatibility of the aid with the common market must be made from the standpoint of the Community. The Commission has to take into account the development of a sector as a whole and not only the development of the recipient of the aid,

— the aid will seriously distort competition and affect trading conditions to an extent contrary to the common interest by transferring the Air France group's difficulties to its competitors. The French Government should not grant any privileged treatment to the Air France Group and should refrain from discriminating against the Air France group's competitors in particular, regarding multidesignation, and access to airport facilities (e.g. access to Orly West). The Air France group should refrain from increasing capacity or fixing its tariffs below its costs and on some routes within Europe, which are characterized by intense competition, and on certain non-European routes (e.g. French West Indies) the Air France group's capacity should be limited and the Air France group should not be price leader. Finally, the French domestic market should be opened up to competition, in particular following the two Commission Decisions of 27 April 1994 concerning access to the Paris-Orly airport,

— should the Commission consider the aid to be compatible with the common market, the Air France group must be prevented from acquiring shareholdings in any other air carriers and the aid must be the last in favour of the group,

— the Commission should define the 'commercial reasons' which may justify government interference in management,

— strict monitoring is required and the payment of the subsequent tranches of State aid should be subject to the achievement of specific targets.

V

The French authorities' submissions in reply to the Commission's letter informing them of the opening of the Article 93 (2) procedure relate principally to the Plan and the proposed recapitalization of CNAF. Moreover, by letter of 14 July 1994 the French Government provided the following clarifications and gave the following commitments :

The commitments given by the French authorities in that letter relate to Air France and 'by Air France we mean CNAF and any company of whose capital it holds more than 50 % with the exception of Air Inter'.

1. The French authorities undertake to ensure that the entire amount of aid will benefit Air France alone. In order to prevent any transfer of aid to Air Inter, a holding company will be set up by 31 December 1994 which will hold a majority shareholding in Air France and Air Inter. The Government also undertakes to ensure that no financial transfers will be made between the companies in the group, either before or after the actual setting up of the holding company, which do not form part of normal commercial relationships. Accordingly, all transfers of goods and services between the companies will be carried out at market prices (e.g. maintenance, airport backup facilities, computerized reservation systems and other computer services, establishment of the schedule, representation in other countries, etc.); in no case will Air France apply preferential tariffs in favour of Air Inter.

2. The French Government confirms its intention to privatize Air France. The privatization process will begin once the company's economic and financial recovery has been achieved, in accordance with the Plan. The decision on the actual transfer of Air France from the public to the private sector will be taken, having regard also to the situation on the financial markets, in such a way that this sale of shares is not to the detriment of public assets.

3. The French Government informs the Commission that as a result of the work carried out since 11 April 1994 to establish detailed rules for implementing the Plan for the company and the outcome of negotiations held with organizations representing employees (ground and flying personnel), it is possible to implement all the measures contained in the restructuring plan.

It should be noted in particular that the framework agreement signed on 31 March 1994 by six unions and approved by a seventh on 6 April 1994 was also endorsed on 9 June 1994 by the three professional organizations representing technical navigation staff.

In these circumstances, the French Government confirms that Air France will continue the process of implementing in full the Plan as communicated to the European Commission on 18 March 1994, in particular as regards the following productivity targets expressed by the equivalent revenue passenger kilometre/employee ratio for the duration of the restructuring plan :

— 1994 : 1 556 200 equivalent revenue passenger kilometre/employee,

— 1995 : 1 725 500 equivalent revenue passenger kilometre/employee,

— 1996 : 1 829 200 equivalent revenue passenger kilometre/employee.

The French authorities also undertake :

4. to adopt the normal behaviour of a shareholder *vis-à-vis* Air France, to allow the company to be managed solely in accordance with commercial principles and to abstain from intervening in its management for reasons other than those connected with its status as a shareholder ;

5. not to grant to Air France, for the duration of the restructuring plan, either any new appropriation or any other form of aid (without prejudice to Article 4 of Regulation (EEC) No 2408/92 as regards possible compensation for public service obligations) ;

6. to ensure that, during the implementation of the Plan, the aid is used exclusively by Air France for the purposes of restructuring the company and not acquire new holdings in other air carriers ;

7. to make payment of the second and third tranches of the capital increase dependent on the actual implementation of the Plan and achievement of the planned results (particularly as regards profits and cost-effectiveness ratios expressed in equivalent revenue passenger kilometre/employee) ;

8. to submit to the Commission a report on the progress of the restructuring plan and the economic and financial position of Air France. These reports will be submitted at least eight weeks before the release of the second and third tranches of aid in 1995 and 1996 ;

9. to accept that the Commission, if it considers it necessary, may have the proper implementation of the Plan and the fulfilment of the conditions laid down for the approval of aid verified, in the light of, *inter alia,* the business environment and market trends, by independent consultants chosen by the Commission in consultation with the French Government ;

10. not to increase, during the period covered by the Plan, the number of aircraft in the CNAF operating fleet beyond 146 ;

11. not to increase, during the period covered by the Plan, the supply of CNAF beyond the level reached in 1993, for the following routes :

— from Paris to all destinations in the European Economic Area (7 045 million available seat kilometre),

— from provincial airports to all destinations in the European Economic Area (1 413,4 million available seat kilometre).

This supply could be increased by 2,7 % each year, unless the growth rate of each of the corresponding markets is lower. However, if the annual growth rate of these markets exceeds 5 %, supply may be increased beyond 2,7 %, by the amount of increase above 5 % ;

12. to ensure that Air France does not, during the period covered by the Plan, apply tariffs below those of its competitors for an equivalent supply on the routes that it operates within the European Economic Area ;

13. not to grant preferential treatment to Air France in the matter of traffic rights ;

14. to ensure that Air France does not operate, during the period covered by the Plan, more scheduled routes between France and the other countries in the European Economic Area than it did in 1993 (89 routes) ;

15. to limit, during the period covered by the Plan, the supply of Air Charter to its 1993 level (3 047 seats and 17 aircraft), with a possible annual increase corresponding to the market growth rate ;

16. to guarantee that any transfer of goods or services from Air France to Air Charter reflects market prices ;

17. to ensure that Air France disposes of its shareholding in the Meridien hotel group by the end of the year on the best possible financial, commercial and legal terms.

Moreover, by letter of 18 July 1994 the French Government gave the following two further commitments :

18. the French Government, in cooperation with Aéroports de Paris, will proceed, as soon as possible, with its modification of the traffic distribution rules for the Paris airport system in accordance with the Commission Decision of 27 April 1994 on the opening of the Orly-London link ;

19. the French Government will ensure that the work required to adapt the two Orly terminals carried out by Aéroports de Paris, and a possible saturation of one or other of these terminals, do not affect competitive conditions to the detriment of the airlines operating there.

VI

Article 92 (1) of the Treaty and Article 61 (1) of the EEA Agreement provide 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 is, in so far as it affects trade between Member States and the Contracting Parties, incompatible with the common market and the Agreement.

The Treaty and the EEA Agreement establish the principle of neutrality with regard to the system of property ownership existing in the Member States (Article 222 of the Treaty and 125 of the EEA Agreement) and the principle of equality between public and private undertakings. As a consequence of these principles, the Commission's action may not prejudice or advantage public entities when they inject capital into undertakings. However, the Commission must investigate financial injections into companies to prevent Member States from infringing the State aid rules of the Treaty.

In order to determine whether State aid is involved, the Commission will base its assessment upon the 'market economy investor principle'. According to this principle, no State aid is involved where fresh capital is contributed in circumstances that would be acceptable to a private investor operating under normal market economy conditions (1).

The Commission is of the opinion that in the case of the acquisition of shareholdings in public companies State aid is involved 'where the financial position of a company, and particularly the structure and volume of its debts, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested' (2). As regards the market economy investor principle the Court of Justice has stressed that the behaviour of a private investor, with which the intervention of the public investor has to be compared, must at least be that of a private holding company or of a private group which follows a structural, global or sectoral policy and which is guided by profitability prospects in the longer term (3). In the case of loss-making companies, such a long-term investor would base his decision on a coherent restructuring plan. The Commission has asked the French authorities for information about the expected return on investment. The French authorities maintain that the decision to increase CNAF's capital injection reflects a rational strategy of the majority shareholder. From a financial perspective, the increase in capital is a better option than the liquidation of CNAF. The French authorities, taking into account the burdensome social liabilities, the substantial loans and the low liquidation value of the company's assets, maintain that the cost of the winding up of the company would be approximately FF 30 billion which is higher than the FF 20 billion capital injection.

The French authorities have not provided any information on the basic data or on the method used to calculate the amount of FF 30 billion. Nor have they provided any information showing that the liquidation value of the company (that is the immediate realizable value of the assets minus all relevant legal obligations) is really negative or even at minus FF 30 billion. In that context one has to note that under normal commercial conditions no shareholder is obliged to pay more, in case of the liquidation of a public limited company, than the capital subscribed to. In any case, the Commission considers that, in the light of the huge amount of CNAF's debts, negative cash flows and continuous substantial losses, and in the light of the characteristics of the industry, namely a low margin return, a rational private investor could not expect, even in the long term, an adequate return on the investment under examination. It is extremely unlikely that CNAF, which, according to the consultants' financial projections, will achieve the first positive net result (FF 400 million) in 1996, could generate adequate profits to sufficiently remunerate the Government's financial efforts.

The Commission is therefore of the opinion that the notified capital injection into CNAF constitutes State aid.

Taking into account the large European network of CNAF and the intense competition existing on most of CNAF's routes, the aid distorts competition within the EEA. Given the international character of the civil aviation industry the aid affects trade between the EEA countries.

In the light of the foregoing, the Commission considers that the planned capital injection into Air France constitutes aid pursuant to Article 92 (1) of the Treaty and Article 61 (1) of the Agreement.

In the light of the present structure of the Air France group, the capital increase of the parent company (CNAF) should be considered as aid in favour of the whole group. However, following the information provided by the French authorities on the future structure of the group

(1) See Commission communication to the Member States concerning public authorities holdings in company capital of 17 September 1984, *Bulletin of the European Communities* No 9-1984 and the Judgment of the Court of Justice in Joined Cases 296 and 318/82, *The Netherlands and Leeuwarder Papierwarenfabriek BV* v. *Commission*, [1985] ECR, p. 809, paragraph 17 at p. 823.

(2) Communication to the Member States concerning public authorities holdings in company capital, in Bulletin EC No 9-1984.

(3) See Case C-305/89, *Italy* v. *Commission*, [1991] ECR I, p. 1603, paragraph 24 at p. 1641.

and the commitments given to avoid any spill-over effects in favour of Air Inter (commitment No 1), the Commission considers that the beneficiary of the aid is CNAF and its subsidiaires, including Air Charter (see point 4 below).

The Commission cannot consider the aid to CNAF as compatible with the common market pursuant to Article 92 (2) of the Treaty or Article 61 (2) of the EEA Agreement, since the aid does not correspond to any of the cases provided for under those provisions.

Article 92 (3) of the Treaty and Article 61 (3) of the EEA Agreement list aid which may be considered compatible with the common market.

Article 92 (3) (a) and (c) of the Treaty and Article 61 (3) (a) and (c) of the EEA Agreement provide for exceptions in respect of aid to promote or facilitate the development of certain regions. The aid to CNAF does not seem to qualify for the exemptions laid down in Article 92 (3) (a) or (c), in so far as it relates to regional aid, nor have the French authorities put forward any such regional arguments in support of the proposed aid.

As for Article 92 (3) (b) of the Treaty and Article 61 (3) (b) of the Agreement, it should be noted that the aid in question is not intended to promote the execution of an important project of common European interest nor to remedy a serious disturbance in the French economy. Moreover, the French authorities have not invoked this provision.

With regard to the exception pursuant to Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement for 'aid to facilitate the development of certain economic activities', the Commission may consider some restructuring aid as compatible with the common market if it meets a number of conditions [1].

These conditions must be seen in the context of the two principles set out in Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement: the aid must be required for developing the activity from the standpoint of the Community and the aid may not adversely affect trading conditions to an extent contrary to the common interest [2].

These criteria have been interpreted in a sectoral (aviation) context in Memorandum No 2 which stipulates that the Commission may, in certain cases, decide in accordance with Article 92 that aid may be granted to individual airlines which have serious financial difficulties, provided certain conditions are met:

(a) the aid must form part of a programme, to be approved by the Commission, to restore the airline's health, so that it can, within a reasonably short period, be expected to operate viably without further aid;

(b) the aid in question must not transfer the difficulties from that Member State to the rest of the Community;

(c) any such aid must be structural so that it is transparent and can be verified.

The Commission verified whether the conditions laid down in Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the Agreement are satisfied, to assess whether the aid is compatible with the common market.

1. The Commission verified the present situation of the civil aviation industry.

In the first half of 1994, the civil aviation industry appears to have virtually recovered from the economic crisis started with the Gulf war in the second half of 1990. Passenger traffic increased by 14 and 9 % in 1992 and 1993 respectively (source AEA). This strong growth trend had been confirmed by the results recorded in the first months of 1994 (January to May), when passenger traffic grew by 9,1, 9,9, 14,1, 5,9, and 6,1 % each month, over the corresponding period last year. Even if growth in passenger traffic in April and May was below the strong growth recorded in the first three months of 1994, one of the areas where growth was maintained was Europe (in May intra-European traffic increased by 8,8 % over the corresponding period in 1993). Despite these positive results some of the European airlines are still loss-making.

One of the main causes of these losses resides in the worldwide economic recession, which has amplified the effects of the Gulf crisis and has had tremendous effects in the air transport sector, which is particularly sensitive to changes in the general level of economic activity. Many passengers travelling in business class, which is traditionally a high-yield sector of activity, are seeking lower tariffs and this contributes to the poor financial results of the airlines. Another factor which has negatively affected the results of the companies is the fact that investments in aircraft made at the end of the 1980s were on the basis of optimistic commercial programmes. The delivery of these aeroplanes has caused overcapacity because the substantial increase in supply has not been off-set by a corresponding increase in demand. For many airlines load factors are still not sufficient to achieve commercially viable operation and thus to fill the aeroplanes they are obliged to offer promotional fares even in the winter season.

[1] Eighth report on competition policy, point 176.
[2] See the Judgment of the Court of Justice of 17 September 1980 in Case 730/79 — *Philip Morris* v. *Commission*, [1980] ECR, p. 2671.

However the prospects for the European aviation industry are quite positive in the medium term (1994 to 1997). (The forecast annual increase in traffic is around 6 %, see IATA annual report for 1993.) Overcapacity would appear to be, in the light of these forecasts, a phenomenon of temporary duration that might be overcome by 1995. (See Commission communication : The way forward for civil aviation in Europe, COM(94) 218 final, p. 7). This is confirmed by the steady increase in load factors during the first months of 1994 (in April and May 1994 load factors were 65,2 % and 65,7 % respectively).

In the light of the above, the Commission considers that the European air transport market is not affected by a structural over-capacity crisis and the state of the aviation industry does not require general capacity cut-backs.

2. The Commission assessed the viability of the Plan.

The aid under scrutiny is aimed at financing the implementation of the Plan and restructuring the finances of CNAF. In opening the Article 93 (2) procedure, the Commission considered that, taking into consideration the present structure of the Air France group, one of the Plan's weaknesses is that it concentrates exclusively on CNAF leaving aside the economic situation and the prospects of the whole group, or at least the main subsidiaries. To this end, the Commission needed more information on the strategies and the plans for the main subsidiaries.

In the course of the procedure the French authorities have informed the Commission that before 31 December 1994 they will set up a holding company which will own a majority shareholding in CNAF (including its subsidiaries) on the one hand and Air Inter on the other hand [1]. Moreover, all the transfers between the two companies will be on market conditions. The Commission underlines that this reorganization must not involve any transfer of State resources as a counterpart for the transfer of Air Inter shares from CNAF to the holding company.

In addition, the French authorities have clarified that Air France will shortly dispose of its major subsidiaries (e.g. the hotel chain Meridien) in order to contribute to the financing of the restructuring plan and to focus on the core air transport activity. Following specific observations on this issue, the Commission welcomes the commitment from the French authorities that Air France will sell its shareholding in Meridien before 31 December 1994 on the financial, commercial and legal conditions most favourable for Air France (commitment No 17). The fact that the French Government has decided that Air France will sell Meridien at the highest possible value minimizes the need for the State to recapitalize Air France.

In this context, the Commission is satisfied that after the planned sales no other non-core assets remain to be disposed of which could raise significant sums of money.

As regards the funds needed for fleet investment, the Commission takes note of the postponement of aircraft orders. Moreover, orders have already been reduced by 21 % and efforts have been taken to further adjust the orders. Consequently, the average fleet age will increase till the end of the period of restructuring from about 7,9 to about 9,3 years. A further delay of fleet investment would mean a further deterioration of this figure which could harm Air France's competitiveness and endanger the viability of the restructuring.

The information provided by the French authorities meets the concerns expressed by the Commission in opening the procedure. The future structure of Air France and the clarifications on the disposal of the major non-core assets shows the cohesiveness of the Plan. This justifies the future strategy of the company which will be targeted to resolve the airline's problems.

As regards the feasibility of the Plan, the Commission's assessment is as follows. The Plan sets out a number of measures that represent genuine efforts toward the restructuring of the airline.

The Commission recognizes, in particular, the great efforts undertaken by the management of Air France for the development of a viable programme, particularly in the social field. Wages will be frozen during the period of restructuring and promotions will be blocked in 1994 and might be blocked in 1995 and 1996, depending on the situation of Air France. Work time will be better utilized and increased up to the legal maximum level. Air France will distribute free shares to employees who will be able to increase their shareholding as compensation for a reduction in wages. The personnel concerned has approved the programme through a referendum. Following the information provided by the French authorities on the approval of the Plan by the unions, the Commission is now convinced that the social measures provided for in the Plan can be fully adopted and the overall restructuring plan successfully implemented.

[1] Hereinafter, CNAF and its subsidiaries are referred to as 'Air France'.

The strong points of the Plan are certainly the planned restructuring of the airline (profit centres, streamlining of the hierarchical structure) in an effort to fully rationalize the functioning of the company.

As regards productivity, the improvements envisaged by the Plan will lead Air France to a position of 'good average' compared to other European airlines. The Commission bases its analysis on a comparison of the efficiency indicator equivalent revenue passenger kilometre/employee. Equivalent revenue passenger kilometre is a composite figure representing revenue passenger kilometre and revenue tonne kilometre (converted to be comparable with passenger revenue yield, on the basis of one tonne kilometre is equivalent to 3,5 passenger kilometre). This comprehensive indicator represents the total level of demand for an airline's services in terms of both passengers and cargo, in particular if the freight sector is so important as in the case of Air France. It also reflects any improvement of Air France's weak points as regards low load factor and insufficiently dense network. (The latter would not be the case if the efficiency target was based on the offer, expressed in available seat kilometre.)

Air France productivity will improve by 33,3 % over the restructuring period (from 1,372 million in 1993 to 1,829 million in 1996). The ratio achieved by Air France in 1996 will be higher than the estimated average ratio achieved by the seven other largest European airlines (Lufthansa, British Airways, KLM, Alitalia, Iberia, SAS, and Swissair which will on average achieve 1,807 million). This is even more remarkable since their average (1,547 million) was in 1993 higher than the figure achieved by Air France (1,372 million).

The Commission considers that a successful implementation of the Plan is capable of restoring the economic and financial viability of Air France, which is the largest French air carrier and one of the three largest European ones. In this respect it is worth recalling that Air France has already started to successfully implement the Plan. At the end of May 1994, Air France made a gross operating profit which is FF 10 million higher than the figure forecast, even though the yields were still rather low.

The Commission notes with satisfaction the commitment given by the French Government that Air France will be run in accordance with commercial principles (commitment No 4). This implies that the French Government will, as majority shareholder of Air France, adopt a behaviour in the best commercial interest of Air France and will not follow a policy of interference in the management of the company for reasons other than those stemming from its role of shareholder.

It stems from the abovementioned commitment that the French Government has to treat Air France as a normal undertaking, in particular with regard to the granting of traffic rights or the occupation of airport surfaces. (See commitment No 13.)

A genuine restructuring of Air France will contribute to the development of the European air transport industry by improving its competitiveness in the aviation sector and is, therefore, in the common interest [1].

3. The Commission verified whether the aid is proportionate to the needs of the restructuring.

In the present case the French Government notified the Commission of its intention to inject FF 20 billion to be paid in three tranches (10 billion in 1994, 5 billion in 1995 and 1996) in Air France.

In deciding to open the Article 93 (2) procedure, the Commission considered that there might be a risk that the aid could lead to overcapitalization of the airline. In the case of Air France, gearing ratios are strongly influenced by the classification of a number of bonds issued by the company in the 1991 to 1993 period. Air France's gearing ratios vary considerably according to whether these bonds are, from an accounting point of view, classified as equity or debt.

Air France has issued the following financial instruments over the past five years:

1. ORA ('obligations remboursables en actions')

   — December 1991 : FF 1 250 000 000,

   — April 1993 : FF 749 996 536.

   The interest payment is composed of a fixed element and a variable element linked to the profits of the company. The holders have the right to demand the conversion of their bonds into shares from 1 June 1993. The conversion into shares on a one-to-one basis will take place at the latest on 1 January 2000.

2. TSDI ('titres subordonnés à durée indéterminée reconditionnés')

   — June 1989 : FF 2 500 000 000,

   — May 1992 : FF 2 600 000 000.

   Part of the value of the loan is placed with a third party ('trust') carrying a zero coupon, which at the end of 15 years will have the same value as the nominal amount of the outstanding loans. The lenders agree, at the end of the 15-year period, to sell the TSDI to the trust. Payment of interest on the TSDI, ceases at the end of 15 years.

[1] See the Commission's action programme : 'The way forward for civil aviation in Europe' COM(94) 218.

3. TSIP-BSA ('titres subordonnés à intérêts progressifs assortis de bons de souscription d'actions')

— April 1993 FF 749 355 800.

Each security has a coupon attached which can be converted into shares at the option of the lender at any time until 1 January 2000. As from 1 January 2000, Air France can repay the loans. The rate of interest payable on the loans is progressive, and acts as an incentive to repay the loans after the year 2000. Air France can suspend the payment of interest where the group makes a consolidated loss higher than 30 % of own and quasi-own capital. In these circumstances, the interest is postponed and earns interest in its own right.

With regard to the possible overcapitalization of Air France and the financial nature of the bonds issued by Air France, the Commission examined two reports by Lazard Frères and one report by Cabinet Constantin. The reports of Lazard Frères, which analyse the impact of the aid on the financial ratios of Air France, stress the necessity to take into account not only capital structure ratios ('ratio de structure financière'), but also capacity to service debts ('ratio de couverture des frais financières') and return on investment ('ratio de rentabilité des fonds propres'). The ratios on capital structure show that in 1996 Air France's position will be more than satisfactory in comparison with the more efficient airlines in the industry such as British Airways. The picture is less positive when the return on investment and capacity to service debts ratios are measured ; in this respect Air France is worse off than British Airways.

The report of Cabinet Constantin concerns the financial nature and ranking of the ORA, TSDI and TSPI-BSA issued by Air France. According to these consultants, one of the fundamental conditions to be fulfilled to classify a bond as equity is the absence of an obligation to pay interest in case of insufficient profits. None of the securities issued by Air France fulfils this condition before its maturity. Moreover, the TSDI have been 'reconditionés' (i.e. Air France will repay the TSDI in the 15th year following the issue with a zero coupon bond acquired with part of the money raised with the TSDI. In the 15th year the value of the zero coupon bond will be equal to the value of the whole TSDI issue). From an accounting perspective, the TSDI are depreciated on an annual basis and will disappear from Air France's financial statements at the end of the 15-year period. The TSDI must, therefore, be considered as a loan redeemable in 15 years. On the other hand, the TSPI-BSA (provided that market conditions enable the owner to exercise the BSA) and the ORA will be equity in due course.

With regard to the distinguishing features of equity and loans, there are a number of fundamental differences on the rights attached to equity as opposed to loan capital. Holders of equity capital may share in the residual profits of the company after all expenses (including interest on loan capital) have been met. They also have the right to a share in the residual assets of the company in the event of its liquidation, after all other creditors have been satisfied. They also have voting rights in the decisions affecting the management of the company.

Holders of loan capital have a predetermined rate of return on their loans (which may be linked in some way to the profitability of the company). They have the right to be paid interest whether or not the company generates sufficient profits. Finally, they have the right to be repaid in priority to holders of equity capital in the event of the liquidation of the company.

The criteria which determine the classification of loan capital are to be found in Article 248-8h of the French Decree of 23 March 1967, which sets out the principles for the presentation of capital instruments in consolidated accounts. It states that 'capital raised as a result of a bond issue which provides neither for the reimbursement at the lender's initiative nor for the obligatory payment of interest in the absence or the insufficiency of profits, can be entered in the consolidated balance sheet under the heading own funds'. Therefore, in accordance with the second element of this Article, an instrument that does have the right to interest payment in the absence of profits, should not be considered as own funds (equity capital).

Furthermore, Article 9 of Council Directive 78/660/EEC on the presentation of company accounts, requires that convertible loan instruments should be shown separately in the balance sheet from the equity of the company. The convertible loans must be shown separately under the heading 'Creditors', subheading 1 — 'Debenture loans'.

In the light of the above, the classification of all Air France's capital issues not as equity but as debts would appear superficially justified. However, whilst the application of strict accounting criteria for the classification of capital instruments is necessary for transparency in the presentation of information in the annual accounts of undertakings, it does not fully reflect the ambiguous financial nature of the instruments themselves.

The abovementioned Article 248-8h of the French Decree defines the criteria which prevent certain capital instruments being classified as own equity, but does not examine their possible treatment as quasi-equity ('autres fonds propres'). This intermediate form of capital is provided for in Article 13 of the French Decree of 29 November 1983. However, in order to

limit the risk that this classification of capital instruments causes confusion with the term equity, the Comité Professionnel de Doctrine Comptable is proposing that it should be replaced by the classification 'other debts of a specific nature' (autres dettes à caractéristiques particulières) or 'non repayable instruments' (titres non remboursables et assimilés).

Nevertheless, the convertible nature of both the ORA and the TSIP-BSA could support the proposition that these instruments should be considered as quasi-equity, since there is an implicit understanding that the lender will convert his loan into equity at some future date. In the case of the ORA, there is an obligation on the lender to convert on a one-for-one basis. For the TSIP-BSA, the lender has accepted a lower rate of interest on his loan in the expectation that the coupon giving the right to purchase Air France group shares at a specified rate will provide a compensating reward.

If the lender did not intend taking advantage of the conversion possibility, he would not have considered lending at the lower rate.

It is clear that the subscribers to the ORA issue were aware that in the course of time their loans would be converted into equity, and that there is no provision for the repayment of the loan in any other form. Therefore, for the purpose of calculating the financial ratios, and in particular, the gearing ratio (equity/loans), it is more appropriate to classify the ORA as quasi-equity. However, as regards the TSIP-BSA, the lender is under no obligation to convert, and therefore the intention to convert is less clear. In such circumstances, if one was obliged to classify this type of financial instrument in one category or another, it would appear more appropriate to classify the TSIP-BSA as debt.

As regards the TSDI, there is no conversion possibility, therefore there is no doubt that the instrument is loan capital.

It must be recalled that in November 1993 the Commission opened the Article 93 (2) procedure with regard to the subscription by CDC-P to the ORA and TSIP-BSA issued by Air France in April 1993 (OJ No C 334, 9. 12. 1993). The Commission has decided today that this operation, which was not lawfully notified to the Commission, is aid in favour of Air France. The aid is illegal and incompatible with the common market and with the EEA Agreement and, thus, must be repaid.

Therefore, on the basis that:

— the capital injection made by CDC-P of FF 748 million ORA and FF 749 million in TSIP-BSA is repaid, and thus the corresponding amounts are substituted by conventional debts,

— the remaining ORA of FF 1,250 billion are deemed to be quasi-own capital,

the structure of the Air France group balance sheet by the end of 1996 is as follows:

Own capital
17,4 + 1,25 ORA = FF 18,65 billion

Debt
22,1 − 1,25 ORA = FF 20,85 billion

Gearing ratio (debt/equity) = 1,12

This ratio appears to be above average for the civil aviation industry, where 1,5 is considered to be an acceptable debt-equity ratio (see *Accounting policies, disclosure and financial trends in the international airline industry,* a survey by KPMG in association with IATA, page 26, August 1992).

In principle, Air France might have, besides the aid, three possibilities to improve its financial standing through its own efforts: improvement of efficiency which leads to increased cash flows, postponement of aircraft orders and the sale of assets. As mentioned above, the Commission acknowledges the effort undertaken to improve labour productivity which will lead Air France to a sufficient level of efficiency at the end of the restructuring period. Second, aircraft orders have already been delayed; further postponement would take the average fleet age beyond 10 years, a level which is too high for an airline aiming at regaining its competitive strength.

As regards the sale of assets, there are only a limited number of assets whose sale could bring in significant amounts of money, such as Meridien, Sabena, Air Inter. The latter two are important core assets for Air France's aviation business. The sale of the remaining assets is already part of the Plan. Other assets are generally small and/or loss-making; their sale would not lead to a significant reduction of the amount of the aid. Therefore, the amount of aid does not appear to be excessive in relation to what is necessary to make good Air France's financial position and put it back on a sound financial footing. In this context, it must be recalled that the civil aviation industry is low margin and capital intensive. Under these circumstances, a gearing ratio of 1,12 does not appear over-prudent. This is further demonstrated by the fact that Air France in 1996 will obtain an interest cover ratio (gross operating profit before depreciation and leases/interest + operating leases) of 2,44, which is very close to 2,42 which was the ratio achieved on average by its competitors in 1993 (SAS, American Airlines, Swissair, Lufthansa, British Airways, KLM and Finnair). As a consequence of the recapitalization, Air France will have an adequate financial structure to service debt with a margin of safety and to borrow on a stand-alone basis without Government support.

On the basis of the above, the Commission is satisfied that the aid to Air France is both necessary and proportionate to enable the company to accomplish successfully its restructuring plan and return to viability. However, given the fact that the aid will be paid in three tranches the Commission intends to monitor carefully, on an annual basis, the fulfilment of the Plan, in particular in the light of the development of Air France's financial situation following, *inter alia*, the sale of assets, and may if necessary, adapt the amounts to be paid to ensure that the level of the aid is still porportionate to the objectives of the Plan.

4. The Commission verified that the aid does not affect trade to an extent contrary to the common interest.

In opening the procedure the Commission stated that it had to examine the effects of the aid on the competitive situation of Air France on the international and domestic routes upon which it competes with other European carriers. The Commission thought that given the present structure of the group, aid to Air France could have spill-over effects for the benefit of its subsidiaries (in particular Air Inter and Air Charter).

As stated above, the French Government gave the commitment (commitment No 1) that Air France will be the only beneficiary of the aid and to this end it will set up a holding company which will control both Air Inter and Air France. Every financial transaction, or transfer of goods and services between the two subsidiaries shall, both before and after the establishment of the holding company, take place under market conditions and no preferential tariffs will be applied in favour of Air Inter.

The Commission considers that this commitment limits concern on the issue of possible seepage effects of the aid in that it virtually prevents Air France from using aid to cross-subsidize Air Inter's activities.

In the light of the information on the future structure of the holding company and the corresponding commitment from the French authorities, the Commission has limited the analysis of the effects of the aid on trade to Air France, which is the actual beneficiary of the aid. In verifying that aid does not adversely affect trading conditions to an extent contrary to the common interest, the Commission has to make sure that aid is not used to undercut prices and thus dump excessive capacity, and in any case that capacity is not increased to an extent higher than market growth.

In the course of the Article 93 (2) procedure, the French Government gave the commitments that:

— CNAF will not increase its operating fleet beyond 146 aircraft (commitment No 10),

— that CNAF will not increase its supply on all routes between Paris and all destinations within the European Economic Area, other than France, and on all routes between French provincial airports and all destinations within the European Economic Area beyond its supply in 1993. Air France will only be allowed to increase its annual supply in proportion to the actual increase in traffic, but always to a lesser extent than market growth (commitment No 11),

— that Air France will not be price-leader on its routes within the European Economic Area (commitment No 12). The Commission is of the opinion that this commitment (that is that Air France will not propose any tariffs which are lower than those of its competitors for an equivalent product within the European Economic Area) will not allow Air France to behave within the European Economic Area in a manner which is normally associated with price-leadership. That means that Air France will, during the period of the restructuring, be limited in its commercial strategy and will not be able to introduce lower tariffs than generally offered by its competitors. In that context, the 'equivalent offer' by Air France's competitors has to be interpreted widely with regard to the nature of the individual product, its conditions and restrictions, etc.,

— that Air France will not operate a number of scheduled routes between France and the other countries in the European Economic Area higher than that operated in 1993 (commitment No 14),

— that Air Charter will not increase its supply beyond the level attained in 1993, plus an annual increase proportionate to the growth of the market (commitment No 15),

— that all transfers of goods and services between CNAF and Air Charter reflect market prices (commitment No 16).

The Commission considers that these commitments involve severe limitations on capacity, supply, and pricing freedom for Air France, which are necessary to prevent the aid's being used to transfer the airline's difficulties to its competitors. The commitments will prevent Air France from pursuing an aggressive price policy on all the routes operated by the French carrier within the European Economic Area. In this respect, it

should be noted that during the first four months of 1994 Air France has, according to the Plan, reduced its supply in the European market (Air France's supply has decreased by 6,4 % over the corresponding period in 1993, while that of European airlines has increased on average by 3,8 % ; by way of example, that of British Airways and KLM has increased by 5, 7 % and 7,3 % respectively).

By limiting Air France's supply even below market growth its market within the European Economic Area will decrease, to the benefit of its competitors. This will prevent the aid from affecting trade to an extent contrary to the common interest.

The above conclusions are also valid for the charter activity carried out by Air France. The commitments given by the French Government with regard to Air Charter will have the effect of preventing CNAF from cross-subsidizing the non-scheduled services provided by its subsidiary Air Charter through transfer price practices. In any case, the commitment not to increase Air Charter's supply beyond market growth will offset the distortive effects of the aid on competition in the European charter market.

For the purpose of the analysis of the effects of the aid in the European Economic Area, the Commission must take into account the present situation of increased liberalization in the air transport sector, following the adoption of the third package (1).

The Commission considers that the removal of constraints protecting Air France from competition represents an appropriate compensatory justification for the granting of the aid, which serves the common interest pursuant to Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement (2).

The Commission has to verify that the negative effects of State aid are not reinforced through the use of exclusive rights or privileged treatment in favour of the beneficiary of the aid. In this respect, several problems have to be addressed :

(a) on 27 April 1994, the Commission adopted a decision which declared the present traffic distribution rules for the Paris airport system to be incompatible with the third aviation package (3). The exclusion of most Community carriers from the airport of Orly, which resulted from those traffic distribution rules, ensured a competitive advantage in favour of Air France. These rules on traffic distribution must be modified before the winter season 1994/95 in order to dismantle this competitive advantage in favour of Air France which strengthens the anti-competitive effects of the aid to the detriment of the common interest. In this context the Commission welcomes the commitment from the French authorities to modify traffic distribution rules for the Paris airport system in accordance with the Commission's decision of 27 April 1994 in order to make these rules non-discriminatory, objective, and consistent (commitment No 18) ;

(b) the Orly airport of Paris consists of two air terminals : Orly South, which is reserved for international flights, and Orly West, which is reserved for domestic traffic. Orly West is more modern and better equipped for French domestic traffic than Orly South.

In May 1994, the French Government decided to modify the rules on traffic distribution between the two air terminals. It decided to reserve Orly West exclusively for the Air France group as of 1 November 1995, and transfer the other airlines, which are already operating at Orly West to Orly South. This involves works to adapt part of Orly West to international traffic and part of Orly South to domestic traffic. This privileged treatment reserved to Air France represents a competitive advantage for the airline over its competitors and a serious detriment for the latter's customers. The Commission is concerned that the transfer will take place before Orly South is sufficiently adapted for the new traffic. Moreover, the possibilities of expansion of Orly South are much more limited than those at Orly West (present passenger capacity of Orly South and Orly West is 10 million and 20 million respectively, and traffic in these two terminals in 1993 was 9,5 million and 15,1 million respectively). The French authorities therefore, should re-examine the distribution of airlines between the two terminals sufficiently in time before Orly South is effectively saturated.

This concern is met by the commitment from the French Government to make sure that the works necessary to adapt the two air terminals of the Paris Orly airport as well as the possible saturation of Orly South, do not affect competitive conditions to the detriment of the airlines operating at Orly. It is the Commission's understanding that this commitment will in particular imply that any air carrier operating at Orly South, as well as any EEA airline which intends to start services to Orly in conformity with the modified traffic distribution rules for the Paris airport system, will not be disadvantaged in its development, in particular in there is still spare capacity available at Orly West.

(1) Council Regulations (EEC) No 2407/92, (EEC) No 2408/92 and (EEC) No 2409/92, (OJ No L 240, 24. 8. 1992, pp. 1, 8 and 15 respectively).
(2) See the Commission's decision in Case C-15/94, TAP, not yet published.
(3) See Commission Decision 94/290/EC, (Case VII/AMA/11/93 — TAT — Paris (Orly)-London), (OJ No L 127, 19. 5. 1994, p. 22).

(c) Most of the parties intervening in the procedure have raised the issue of the reinforcement of the anti-competitive effects of the aid, in view of the fact that the French domestic market remains closed to competition in particular in the Orly-Toulouse/Orly-Marseille routes.

In this respect, the Commission must point out that on 27 April 1994, it decided [1] that France must authorize Community carriers to exercise traffic rights on the routes from Paris (Orly) to Toulouse and Marseille at the latest by 27 October 1994. Although this decision has been challenged by the French Government before the Court of Justice, such application has nevertheless no delaying effects pursuant to the Treaty. This implies that France is obliged to comply with the decision by 27 October 1994 and must therefore grant traffic rights to any interested Community carrier on the basis of Regulation (EEC) No 2408/92. Should the routes not be opened by that date, any interested party may invoke the direct effects of Community law before the appropriate national authorities in order to exercise the right to fly these routes. In view of the principle of supremacy of Community law, any national rules opposing the exercise of such fundamental freedoms cannot be applied. Every authority in a Member State, including administrative bodies, is bound by these fundamental principles of Community law, whose respect is also entrusted to the Commission as guardian of the treaties.

Finally, the commitments from the French authorities that :

— the French Government will not interfere in the management of Air France for other than commercial reasons (commitment No 4),

— the aid is the last favour of Air France (commitment No 5) and that will not be used to acquire additional shareholdings in other air carriers (commitment No 6),

meet the remaining concerns expressed by the Commission in opening the Article 93 (2) procedure.

The Commission is of the opinion that the above considerations adequately meet the legitimate concerns of interested parties on this important issue.

In the light of the above, the aid to be granted by the French authorities to Air France in the form of a capital increase amounting to FF 20 billion may benefit from exemption pursuant to Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement, provided certain commitments are respected and a number of conditions are satisfied,

HAS ADOPTED THIS DECISION :

Article 1

The aid to be granted in the period 1994 to 1996 in favour of Air France, in the form of a FF 20 billion capital increase to be paid in three tranches, and aimed at its restructuring in accordance with the Plan is compatible with the common market and the EEA Agreement by virtue of Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the Agreement, provided that the French Government comply with the following commitments :

1. the entire amount of aid shall benefit Air France alone. Air France means the Compagnie Nationale Air France, as well as any company of whose capital it holds more than 50 %, with the exception of Air Inter. In order to prevent any transfer of aid to Air Inter, a holding company will be set up by 31 December 1994 which will have a majority shareholding in Air France and Air Inter. No financial transfer which does not form part of normal commercial relationships shall be made between the companies in the group, either before or after the actual setting up of the holding company. Accordingly, all transfers of goods and services between the companies shall be carried out at market prices ; in no case may Air France apply preferential tariffs in favour of Air Inter ;

2. the process of privatizing Air France shall begin once the company's economic and financial recovery has been achieved, in accordance with the Plan, having regard also to the situation on the financial markets ;

3. Air France shall continue the process of implementing in full the Plan as communicated to the Commissionon 18 March 1994, in particular as regards the following productivity targets expressed by the indicator equivalent revenue passenger kilometre/employee for the duration of the restructuring plan :

   — 1994 : 1 556 200 equivalent revenue passenger kilometre/employee,

   — 1995 : 1 725 500 equivalent revenue passenger kilometre/employee,

   — 1996 : 1 829 200 equivalent revenue passenger kilometre/employee ;

4. they shall adopt the normal behaviour of a shareholder *vis-à-vis* Air France, allowing the company to be managed in accordance with commercial principles alone and abstaining from intervention in its management for reasons other than those connected with its status as a shareholder ;

[1] OJ No L 127, 19. 5. 1994, p. 22.

5. they will not grant to Air France, in accordance with Community law, any new appropriation or any other form of aid;

6. they will ensure that, for the duration of the Plan, the aid is used exclusively by Air France for the purposes of restructuring the company and not to acquire new holdings in other air carriers;

7. they will ensure that, during the period covered by the Plan, Compagnie Nationale Air France does not increase the number of aircraft in its operating fleet beyond 146;

8. they will not increase, during the period covered by the plan, the supply of Compagnie Nationale Air France beyond the level reached in 1993 for the following routes:

   — between Paris and all destinations in the European Economic Area (7 045 million available seat kilometre),

   — between provincial airports and all destinations in the European Economic Area (1 413,4 million available seat kilometre).

   The supply could be increased by 2,7 % each year, unless the growth rate of each of the corresponding markets is lower.

   However, if the annual growth rate of these markets exceeds 5 %, supply could be increased beyond 2,7 % by the amount of increase above 5 %;

9. they will ensure that Air France does not, during the period covered by the Plan, apply tariffs below those of its competitors for an equivalent supply on the routes that it operates within the European Economic Area;

10. they will not grant preferential treatment to Air France in the matter of traffic rights;

11. they will ensure that Air France does not operate, during the period covered by the Plan, more scheduled routes between France and the other countries in the European Economic Area than it did in 1993 (89);

12. they will limit, during the period covered by the Plan, the supply of Air Charter to its 1993 level (3 047 seats and 17 aircraft), with a possible annual increase corresponding to the market growth rate;

13. they will guarantee that any transfer of goods or services from Air France to Air Charter reflects market prices;

14. they will ensure that Air France disposes of its shareholding in the Meridien hotel group by the end of the year on the best possible financial, commercial and legal terms;

15. with the cooperation of Aéroports de Paris, they will, as soon as possible, modify the traffic distribution rules for the Paris airport system in accordance with the Commission decision of 27 April 1994 on the opening of the Orly-London link;

16. they will ensure that the work required to adapt the two terminals at Orly carried out by Aéroports de Paris, and a possible saturation of one or other of those terminals, do not affect competitive conditions to the detriment of the companies operating there.

Article 2

In order to ensure that the amount of aid remains compatible with the common market, the payment of the second and third tranches of the capital increase shall be subject to fulfilment of the above commitments and to the actual implementation of the Plan and achievement of the planned results (particularly as regards the profits and cost-effectiveness ratio as expressed in equivalent revenue passenger kilometre/employee, as well a the sale of shares).

The French Government shall submit to the Commission a report on the progress of the restructuring programme and on the economic and financial situation of Air France. These reports shall be submitted at least eight weeks before the release of the second and third tranches of aid in 1995 and 1996.

The Commission shall have the proper implementation of the Plan and the fulfilment of the conditions laid down for the approval of aid verified, in the light of, *inter alia,* the business environment and market trends, by independent consultants chosen by the Commission in consultation with the French Government.

Article 3

This Decision is addressed to the French Republic.

Done at Brussels, 27 July 1994.

For the Commission

Hans VAN DEN BROEK

Member of the Commission