COMMISSION

COMMISSION DECISION

of 15 July 1997

concerning the recapitalization of the company Alitalia

(Only the Italian text is authentic)

(Text with EEA relevance)

(97/789/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given the parties concerned notice [1], in accordance with the provisions of the abovementioned Articles, to submit their observations, and having regard to those observations,

Whereas:

THE FACTS

I

Alitalia Linee Aeree Italiane S.p.A. (hereinafter referred to as 'Alitalia') was set up on 16 September 1946 with an initial capital of Lit 900 million and is by far the leading Italian airline. It transported 20,9 millions passengers in 1995 and is the fifth largest European airline in terms of passenger-kilometres after British Airways, Lufthansa, Air France and KLM. Its turnover, about Lit 7 830 billion in 1996 (around ECU 4 billion), is comparable to that of SAS, and slightly less than that of the Swissair group. The company's network mainly covers Italy and Europe, but also 40 intercontinental destinations in North and South America, Africa, the Middle East and the Far East. At the end of 1996, Alitalia employed 17 390 people (as against 17 982 at the end of 1995) and had a fleet of 157 aircraft, most of them short- or medium-haul. With an average age of 6,5 years at the end of 1995, this fleet is one of the youngest of the European airlines.

Alitalia's capital is 90 %, held by the State holding company IRI ('Istituto per la Ricostruzione Industriale'), the rest being held by private investors, among them several major international banks. In 1994, Alitalia absorbed its subsidiary ATI, which specialises in domestic flights, and in autumn 1995 transferred to IRI its majority holding (56 %) in 'Società Aeroporti di Roma'. It has 100 % control of the company Avianova, a third-level air carrier which in July 1996 became Alitalia Team S.p.A. (hereinafter: 'Alitalia Team') and has a 45 % holding in the charter company Eurofly, a 27,61 % holding in Air Europe and a 30 % holding in the Hungarian national airline Malev. Alitalia also has holdings in companies whose business is related to air transport: Atitech (100 %); Racom Teledata (93,8 %), which in turn owns 9 % of the computerized reservation system Galileo; Italiatour (99,67 %); Sisam (60 %) and the airport management companies in Naples, Genoa, Turin, Florence, Lamezia Terme and Rimini. The carriage of goods and passengers by air nevertheless makes up 92 % of the group's total turnover. Lastly, apart from limited agreements with the US company Continental for traffic between Italy and the USA and with the company Air France, Alitalia has not so far allied itself with major partners.

Amounting to about Lit 5 000 billion in 1990, Alitalia's turnover increased by 53 % in nominal value between 1990 and 1995. Its net fixed assets rose from Lit 2 701 billion in 1990 to Lit 4 851 billion in 1995. The numbers of available tonne-kilometres and tonne-kilometres carried increased by 29,5 % and 39,5 % over the same period, during which time the company also acquired 69 new aircraft. This increase in business must not, however, hide the difficulties which Alitalia, like most of the European national airlines, has had to face as a result of the

[1] OJ 346, 16. 11. 1966, p. 13/66.

Gulf War, the recession in 1992 and 1993 and the increased competition resulting from the liberalization of the market. Thus the company's average unit receipts (yield), expressed in constant lire terms, fell by 22 % between 1990 and 1995. Alitalia therefore undertook to reduce its costs and increase its productivity, in particular by reducing its ground staff. The operating cost per tonne-kilometre available, expressed in constant lire (1995 value) consequently fell from Lit 1 323 to Lit 1 147, while the number of available tonne-kilometres per employee rose from 219 700 to 349 700 during the same period.

Despite these efforts, Alitalia was unable to return to profitability. The company's operating result did not substantially improve between 1990 and 1996. Though positive in 1994 and 1995 after the deficits at the start of the decade, it again became slightly negative, falling to – Lit 24 billion in 1996, or 0,3 % of the company's turnover. According to the Italian authorities, Alitalia's operating costs are still 12 % higher than the average of its main European competitors, due mainly to excessively high labour costs. Conversely, the company's receipts are somewhat lower than those of its main competitors when the average length of the routes is taken into account, even if this difference is indeed chiefly due to the depreciation of the lira. Alitalia has been losing market share for five years and has been powerless to stop a large part of its customer base in northern Italy from 'draining away' to the hubs of northern Europe, since Rome-Fiumicino airport, the company's main base, is located too far south according to the Italian authorities. Alitalia also had to face considerable labour unrest in 1995 and 1996.

The operating result has been too weak over the last few years to prevent the company's debt and financial charges from building up considerably as a result of the accumulated losses between 1990 and 1996, major investment in new aircraft (Lit 2 150 billion between 1990 and 1995) and, according to the Italian authorities, the company's insufficient recapitalization in the early 1990s. Alitalia's debt thus increased from Lit 653 billion in 1990 to Lit 3 420 billion in 1995, giving rise to substantial financial costs. The company's net result was therefore constantly negative between 1990 and 1995, falling to – Lit 173 billion in 1994 and – Lit 212 billion in 1995. From + 0,586 in 1990, the ratio of long-term debt (excluding leasing) to equity rose to + 2,91 in 1993, + 7,23 in 1994 and + 8,10 in 1995.

On 31 March 1996, Alitalia's cumulative losses amounted to Lit 905 billion and the company's net assets had fallen to Lit 150 billion. This very serious financial situation, verging on bankruptcy, can only worsen, given that losses of Lit 400 billion are expected in 1996.

This is the background against which the Italian authorities sent the Commission the restructuring plan for Alitalia, which is accompanied by large capital injections.

II

The Italian authorities sent the Commission the restructuring plan for Alitalia on 29 July 1996. The notification was registered at the Commission's Secretariat-General on 30 July 1996. An acknowledgement of receipt was sent to the Italian authorities on 14 August 1996.

By letter of 9 August 1996, the Commission notified the Italian authorities that the intervention would be examined in the light of the provisions of Article 92 of the EC Treaty and in the framework of the procedure provided for in Article 93 (2) of the EC Treaty. It also informed them that the information given in the notification of 29 July 1996 was not sufficient to enable it to examine the matter in full knowledge of the facts and therefore requested additional information. In its letter of 9 August 1996, the Commission also reminded the Italian authorities that the provisions of Article 93 (3) of the EC Treaty did not allow proposed State aid mesures to be put into effect until the Commission had adopted a final decision. On 9 September 1996, the Italian authorities sent the Commission most of the information it had requested in its letter of 9 August 1996. A meeting in Brussels between the Commission and the Italian authorities on 17 September 1996 also provided additional information.

According to the Italian Government, the main objective of the restructuring plan is to create favourable conditions for the privatization of the company. The plan, which has been approved by the company's management and trade unions, is accompanied by detailed financial forecasts. It runs for five years (1996-2000) and is in two successive phase which are, however, to some extent interrelated: a restructuring phase in 1996-97 followed by a development phase from 1998 to the year 2000.

The restructuring phase is chiefly designed to reduce Alitalia's operating costs and to bring its ratio of debt to equity down to a reasonable level. It therefore comprises a financial and a management component.

The management component fits in with the efforts which Alitalia has been making since the early 1990s to reduce costs and increase productivity. It is intended to make the company competitive in the short term by pursuing three main aims: reducing costs, maximising receipts and shedding non-strategic activities.

The reduction of costs in particular includes productivity improvements and wage freezes for flying personnel. In this respect, the agreement reached between the company and the trade union representatives on 19 June 1996 will

save costs, during the five-year period from 1996 to the year 2000, of more than Lit 1 000 billion. In return for this cost reduction, employees will receive a net total of Lit 310 billion (Lit 520 billion with tax and social charges), equivalent to the annual saving made in terms of labour costs, to put solely towards the purchasing of Alitalia shares. This agreement is the first of its kind for a quoted Italian company. It assumes that the productivity increases and labour costs reductions will be achieved by reducing allowances, abolishing various benefits and increasing flexibility for existing staff and by setting up a self-contained company, fully controlled by Alitalia, which will take on new cabin personnel on less costly terms. This new company, Alitalia Team, was set up on 23 July 1996. Existing flying personnel will be able to move to this new company voluntarily, thanks to the offer of career incentives, e.g. promotion to higher levels of responsibility.

As for non-flying personnel, the plan provides in particular for reducing ground staff by an additional 1 936 between 1996 and 1998 through early retirement and voluntary redundancies. The cost-reduction programme includes a change in the conditions for ground handling services.

The maximization of receipts consists of two main series of measures: first, Alitalia is to make up for the absence of a proper computerized fares system by introducing an integrated system of fares, fully automating the ticketing process and creating a fare control system to ensure that fare categories match the reservation codes. Secondly, the company will reform its commercial processes, in particular in the domestic market, in order to slow down the drop in receipts by preparing the ground for the segmentation and passenger loyalty strategy which Alitalia intends to develop.

The shedding of non-strategic activities is intended to concentrate the company on its core activities and to release additional financial resources for recapitalization. The plan notified on 29 July 1996 therefore contained disinvestments of about Lit 400 billion during the period from 1996 to the year 2000, in particular the disposal of the administrative centre at Magliana and the disposal of shareholdings in Alfa Romeo Avio and Sisam.

The plan also devotes much effort to the need to adapt or renew the structure of Alitalia's computer systems, in particular in the administrative and commercial sectors.

As far as the financial component is concerned, it is proposed to inject capital initially totalling Lit 3 310 billion: Lit 1 500 billion to be provided by IRI by the end of 1996; a further Lit 1 500 billion to be the subject of a second instalment to be paid in 1997; and Lit 310 billion for staff to have a stake in the company's capital, as stated above. IRI has in fact already advanced Lit 1 000 billion of the Lit 1 500 billion in the first instalment to Alitalia in June 1996, to be set against the future increase in capital. The main aims of these financial measures are to balance the company's capital structure by aligning it on that of the main Community carriers, to fund the proposed development of the fleet, to involve employees in the restructuring project through equity participation, and to start the privatization process. The Italian authorities add that they are also responding, at least in part, to the need to comply with the combined provisions of Articles 2327 and 2447 of the Italian Civil Code, which require Alitalia to have a minimum capital of Lit 200 million. The total restructuring costs provided for in the plan amount to Lit 900 billion and the immediate effect of these exceptional costs would be to push Alitalia's equity, which has already been reduced to Lit 150 billion, below zero.

The total capital increase provided for in the plan should substantially reduce Alitalia's net borrowing between 1995 and 1997, thus reducing its financial costs during that period.

Secondly, the development phase is chiefly based on bringing the Malpensa hub into service as from 1998. According to the Italian authorities, the development of Malpensa will give Alitalia a prime strategic advantage, enabling it to reposition itself on one of the most important markets in Europe, namely that of northern Italy. Strengthening of the company's network in Malpensa, where Alitalia will have a specialised terminal, will include the development of the intercontinental routes serving Milan, in particular those to North America and Asia. This intercontinental network will be fed by transferring domestic and international services from Linate to Malpensa, targeting routes from east to west and increasing services to Eastern Europe and the Middle East.

The creation of the Malpensa hub will be accompanied by restructuring of the terminal at Rome-Fiumicino Airport, which is currently the hub of Alitalia's network. The final structure of this network sees Rome as the Mediterranean terminal but maintaining a strong intercontinental emphasis. Alitalia will therefore have two hubs (Malpensa and Fiumicino) as the end of the period covered by the plan. It should be noted that the plan, as notified to the Commission in July 1996, does not propose discontinuing any of the routes currently operated by Alitalia, not even during the restructuring phase.

During the development phase, Alitalia also plans to introduce shuttle services on the main domestic Italian routes, to reorganize its international network, to develop a series of alliances with its foreign partners and to expand its fleet. According to the plan notified, the shuttle services will have a high level of frequency, a simplified fare structure and ease of booking, these being especially necessary on busy routes on which low-cost organization and a high frequency of services will sharply reduce production costs. The low-cost products may also be extended to the main European routes so as to feed the Malpensa hub. However, the reorganization of the international network will mainly consist of recovering the traffic in northern Italy by introducing new routes from the main airports in the region and rationalising and developing the intercontinental network, in particular to the Far East. A series of alliances targeted on various markets (national, European, intercontinental) should contribute significantly to the expansion of the network. The changes expected between 1998 and the year 2000 were to be accompanied, in the first version of the plan, by an expansion of the fleet which, having been stable from 1995 to 1997 with 157 aircraft, will rise to 172 aircraft in the year 2000 (an increase of 4 long-haul and 11 short-haul and medium-haul aircraft).

Throughout the plan, a particular effort will also be made to improve product quality, to increase customer satisfaction and to create a brand name: Alitalia is at the moment one of the carriers which invest least in quality of service.

The plan sent on 29 July 1996 should, as a whole, according to the Italian authorities, make it possible to transform Alitalia into a very profitable company by the year 2000. Unit production costs in constant lire per seat-kilometre available, which fell by 13 % between 1990 and 1995, are expected to fall by a further 19 % between 1995 and the year 2000. The operating result will increase to Lit 944 billion and the net result to Lit 489 billion, or 9,15 % of turnover, in the year 2000. Turnover is expected to increase modestly at first in 1996 and 1997 and then more sharply in 1998, 1999 and the year 2000, mainly due to the development of the Malpensa hub.

Finally, the Italian authorities stressed in support of their communications of 29 July and 9 September 1996 that the operation to inject Lit 3 000 billion into Alitalia in 1996 and 1997 does not contain State aid components as it meets the principle of the investor operating in a market economy, as defined by the Commission in its guidelines 'Application of Articles 92 and 93 of the Treaty and Article 61 of the EEA Agreement to State aid in the civil aviation sector' [2] and applied in Commission Decision 96/278/EC on the Spanish company Iberia [3]. The operation will provide a return, it is hoped, of more than 30 % which will indeed be due to the dividends paid in 1998, 1999 and the year 2000, but mainly to the figure of some Lit 4 500 billion which will be acquired by the company up to the year 2000. The calculation of profitability also takes account of the costs (more than Lit 1 000 billion) which the IRI group will sustain in the event of Alitalia's bankruptcy. These insolvency costs mainly stem from loans granted to carriers by other companies in the IRI group, in particular Cofiri.

In the light of all of the information given in the communications of 29 July and 9 September from the Italian authorities, the Commission decided, on 9 October 1996, to initiate the procedure provided for in Article 93 (2) of the Treaty on the subject of the capital increases provided for in the plan. The grounds for initiating the procedure are the nature of the capital injections made by IRI, which may be considered to be State resources within the meaning of Article 92 (1) of the Treaty, and the Commission's serious doubts as regards:

— the existence of aid, in view of the low probability of IRI's financial effort being satisfactorily recompensed;

— the possibility of applying one of the derogations provided for in Article 92 (2) and (3) of the Treaty to any aid. Here, the Commission has noted that several of the conditions on which its acceptance of restructuring aid generally depend were probably not met in the case in point.

In its decision to initiate the procedure, the Commission also expressly indicated that it would call on one or more independent consultants in order to obtain information to enable it to make a final assessment in this matter.

By letter of 21 October 1996, the Commission notified the Italian Government of its decision to initiate the procedure and gave it formal notice to submit its comments. This letter was published in the *Official Journal of the European Communities* [4] and the other Member States and interested parties were also requested to submit their comments.

III

By letter of 21 November 1996, the Italian authorities submitted their comments in reply to the Commission's letter of 21 October 1996 informing them of the decision to initiate the procedure. They assert, firstly, that Alitalia has already made major efforts to improve its situation

[2] OJ C 350, 10. 12. 1994, p. 5.
[3] OJ L 104, 27. 4. 1996, p. 25.

[4] See footnote 1.

during the last five years and that careful analysis shows that the company does not at the moment have any handicap in terms of competitiveness, except possibly *vis-à-vis* one or two of its European competitors. The process of restructuring now taking place within the Italian economy should also enable the company to overcome this handicap, which is essentially due to the differences between the economic systems of the Member States of the European Union. In their comments, the Italian authorities then refer specifically to five of the main questions raised by the Commission in its decision to initiate the procedure:

1. The accuracy of the forecasts of growth in the markets in which Alitalia is present

On this subject, the Italian authorities point out that:

— despite the development of the new international airport at Malpensa, the forecast growth in the available capacity of the company is lower than the market growth (5,5 % as against an annual average of 6,7 % during the period covered by the plan), which will result in market losses for Alitalia,

— the data used by Alitalia in its forecasts come from official sources,

— Alitalia, like all other carriers, analyses the profitability of the routes not on a point-to-point basis, but in terms of the 'network',

— the Milan-Rome-Naples high-speed train will not be fully operational until after 2003. Even then, it will have little impact on Alitalia's revenue since it will still be faster to travel by air than by rail, airline passengers will benefit from connecting flights and, lastly, the price difference between travel by air and by rail is likely to narrow.

2. The efficiency of a network designed around two 'hubs' (Malpensa and Fiumicino)

In this respect, the Italian authorities point out that other Community carriers (Lufthansa, SAS, Iberia) have networks based on two hubs. They add that Alitalia's future network based on two hubs is consistent since, firstly, Fiumicino is also well located to serve as a hub for intercontinental flights from north to south and will remain a major international airport in view of the importance of Rome and, secondly, Malpensa is well located to serve as a hub for intercontinental flights from east to west and as a sixth freedom hub for intercontinental flights and will serve the richest part of Italy. With regard more especially to this area, the draining of traffic away from northern Italy to foreign airports has been estimated at 3,3 million in 1995 and the plan notified to the Commission provides for recovering only part of these losses (less than 30 %) by the year 2000.

3. The merits of the plan's objectives as regards catching up in economic and financial terms

According to the Italian authorities, the proposed reductions in labour costs in the plan for the period from 1996 to the year 2000 follow on from the major efforts which have been made since 1990 and must be regarded as the firmest components of the plan, especially in view of the agreement signed with the trade unions on 19 June 1996. In addition, the methodology used to identify the excess number of staff is based on business process reengineering programmes, analysis of the added value for administrative staff and the volumes of activity forecast for operating staff. The Italian authorities also insist on the fact that the programmes set out in the plan will proceed smoothly since Alitalia Team began operating on 1 November 1996 (two months earlier than the initial date) and the staff reduction is taking place more rapidly than expected.

4. The attitude of Alitalia's employees to the plan

On this point, the Italian authorities point out that the trade unions have clearly and unequivocally committed themselves to supporting the plan notified. The general agreement signed with the trade unions on 19 June 1996 thus led to series of implementing agreements with: flight engineers on 30 October 1996; flight assistants on 22 October 1996; and pilots on 4 October 1996, including their possible transfer to Alitalia Team.

5. Calculation of the internal rate of return of the operation

The Italian authorities point out that the method used to calculate the internal rate of return is in conformity with both the Commission's guidelines, in particular as regards the inclusion of insolvency costs in the calculation and Decision 96/278/EC. The direct losses which IRI would sustain in the event of Alitalia's bankruptcy have also been estimated with caution. The rate of average annual growth beyond the year 2000 has been put at 5,9 %.

With regard to the arrangements for the second capital injection, the Italian authorities point out that, even if IRI has confirmed its commitment to pay Lit 1 500 billion as the shareholder controlling the company, minority shareholders or private investors will also be able to contribute to providing this sum with a view to the company's privatization.

Lastly, the Italian authorities inform the Commission that the main obstacle to Alitalia's privatization, namely the rule that IRI had to hold at least 51 % of the capital of the flag company, was recently removed.

IV

Following the initiation of the procedure, the UK, Danish, Norwegian and Swedish Governments and interested parties such as the airlines Air One, British

Airways, British Midland, KLM, Lauda Air, Lufthansa, SAS and Virgin Atlantic, which are Alitalia's competitors, the Association of Airline Companies of the EEC (ACE) and the Associazione Nazionale Utenti di Servizi Publici (Assoutenti) submitted their comments on this matter. In total, four Member States and ten interested third parties, including eight airlines, have produced comments — all approving the Commission's decision to initiate the procedure provided in Article 93 (2) of the Treaty and raising a number of questions relating to the doubts expressed in that decision.

In their observations, the States which commented point out first and foremost that the Treaty rules on State aid must be strictly applied in the civil aviation sector since the process of liberalization based on the provisions of the 'third air package' (Council Regulations (EEC) No 2047/92, No 2408/92 and No 2409/92 [5]) took effect on 1 April 1997. They go on to claim that the recapitalization of Alitalia, as set out in the restructuring plan notified to the Commission, constitutes State aid. Denmark and the United Kingdom in this respect stress the many uncertainties and the unrealistic assumptions on which the plan is based and, further, the fact that no private partner has agreed to take part in this operation. The four Member States add that the aid cannot be exempted under Article 92 (3) (c) of the Treaty since the requirements for such an exemption are not met in the case in hand, in particular because of the expansionist and non-restrictive nature of the restructuring plan. Sweden refers on this subject to the proposed increase in Alitalia's fleet by the year 2000 and the lack of any capacity reduction or termination of unprofitable routes. Denmark and Norway refer specifically to the disproportionate nature of the amount of the aid, which would result in the overcapitalization of the company. The United Kingdom and Denmark also stress that the aid will transfer Alitalia's difficulties to its Community competitors, as it will — in practice — help to finance Alitalia's major investments in new aircraft during the last few years, which are the main cause of its present indebtedness.

With regard to the exemption requirements that should apply to aid, Denmark and Norway refer to Alitalia's disposal of its non-core business. The United Kingdom, for its part, calls for requirements to guarantee non-discrimination as regards slot allocation, ground-handling services, access to airport facilities and the operation of services in Italy, in particular with regard to the transfer of activities from Linate to Malpensa.

Although Denmark also asserts that the Commission's examination should cover all of the Lit 3 310 billion in capital investment provided for in the plan, the UK and Norway on the contrary believe that the Commission's Decision of 9 October 1996 to initiate the procedure refers only to the first capital injection of Lit 1 500 billion and that the second capital injection of the same amount should be the subject of a further decision to initiate a procedure. Lastly, Denmark and Sweden want the Commission to let the Member States and interested third parties have any new information which comes to its attention in this matter by publishing it in the *Official Journal of the European Communities.*

These various points also appear to various degrees, but often in a more detailed manner, in the observations from interested third parties, all of whom believe the recapitalization of Alitalia as proposed is aid incompatible with the Treaty. The interested third parties do nevertheless also make additional points.

Air One, Assoutenti, British Airways, KLM and SAS express the greatest doubts about the development of Alitalia's activity at Malpensa airport as proposed in the plan because of the delay in completing the infrastructure, the problems related to the transfer of traffic from Linate to Malpensa and the difficulties which Alitalia will have in managing two hubs (Malpensa and Fiumicino) at the same time. Air One and Assoutenti also emphasie the uncertainty as regards the exact arrengements for the shareholding of Alitalia staff in the company's capital, since such a shareholding will require the amendment of Italian tax laws. They also believe that the sale of Alitalia's headquarters building will not bring in the amount expected. Air One and Lauda Air draw attention to the additional, unlawful aid which was granted to Alitalia by the Italian State through the funding of early retirement measures covered by Decree Law No 546/96 of 23 October 1996 (converted into Law No 640 of 20 December 1996; hereinafter 'DL 546/96').

With regard to the existence of the aid, besides the lack of private partners for the operation and the uncertain and excessively optimistc nature of the assumptions on which the plan is based, in particular in terms of traffic and revenue, Air One, Assoutenti and British Airways state that the insolvency costs which IRI has borne should not be taken into account when calculating the profitability of the operation, and that Alitalia is at the moment still making losses despite the favourable economic climate. The inadequacy of the measures and the cost reduction provided in the plan notified to the Commission is also an argument put forward by ACE, British Airways, SAS, Air One and Assoutenti. The two last-named companies also believe that the plan underestimates the competitive pressure which Alitalia will have to face in the next few years.

[5] OJ L 240, 24. 8. 1992, pp. 1, 8 and 15.

With regard to the incompatibility of the aid, apart from the expansionist nature of the plan and the disproportionate nature of the proposed capital increase, British Airways and Virgin Atlantic refer first and foremost to the fact that the aid is not essential, since Alitalia should seek the resources needed for restructuring within its own organization by disposing of assets and reducing its costs, as is done by private companies. They add, together with Air One and SAS, that the aid will not enable Alitalia to return to profitability since the plan does not in particular provide either for a sufficient reduction in operating costs or for the disposal of unprofitable parts of the company's business. Air One, British Airways and SAS also stress the lack of transparency in the implementation of the aid. British Airways also refers to the frequent interference by the Italian Government in Alitalia's management and claims that the aid in question will not facilitate the development of economic activity within the meaning of Article 92 (3) (c) of the Treaty, as this criterion has to be considered at Community level, where there is already a competitive, efficient air-transport sector. Furthermore, ACE, Air One, Assoutenti, British Airways, British Midland, Lufthansa and Virgin Atlantic stress the dangers of transferring Alitalia's difficulties to its Community competitors, noting its predatory, anti-competitive practices on the Italian market (swamping, very low fares, manipulation of slots). Lufthansa and Assoutenti point out in this respect that Alitalia was recently fined by the Italian competition authority. Lauda Air and Air One add that the anti-competitive effects of the aid will be amplified by the Italian Decree of 16 April 1992, which grants Alitalia an exclusive right to operate most of the regular air routes between Italy and third countries within the European Economic Area. The interested parties therefore call on the Commission to oppose the operation.

With regard to the requirements which should govern may acceptance by the Commission of the aid granted to Alitalia, the interested third parties chiefly propose the following solutions:

— making Alitalia dispose of its non-core assets (British Airways, Lufthansa, SAS, Virgin Atlantic),

— significantly reducing the amount of the aid (ACE, British Airways, Virgin Atlantic),

— reducing the available capacity of the Alitalia group (ACE, Assoutenti, British Midland, Lauda Air, Lufthansa, SAS, Virgin Atlantic) and requiring Alitalia to stop operating unprofitable routes,

— prohibiting Alitalia from practising price leadership throughout its network (Lufthansa, SAS, Virgin Atlantic),

— ending the legal monopoly which Alitalia enjoys on routes to third countries (Assoutenti, Lauda Air, Lufthansa),

— making Alitalia accept an interline arrangement with new entrants (Assoutenti, Lufthansa),

— prohibiting Alitalia's anti-competitive practices (Assoutenti, Lufthansa),

— ending the discrimination from which Alitalia benefits, in particular as regards ground-handling services (KLM), the distribution of traffic between Linate and Malpensa airports (KLM, Lufthansa), airport taxes and charges (Lufthansa, SAS), and slot allocation (Lufthansa, Virgin Atlantic).

Lastly, several interested parties referred to the lack of transparency as regards the exact amount of the aid covered by the Commission Decision of 9 October 1996 to initiate the procedure.

All of the observations expressed by Member States and interested third parties were forwarded by the Commission to the Italian Government on 18 December 1996 and 15 January 1997. By letter of 15 January 1997, the Italian authorities, in turn, submitted their comments in reply to the observations which had been sent to them. They reaffirm the commercial nature and profitability of the operation of recapitalizing Alitalia and more especially contest five of the points raised by the Member States and the interested third parties.

First, as regards the absence of private partners from the operation, the Italian authorities state that no such partners were sought to subscribe to all or part of the capital increase in question and that the participation of private partners would in this instance be detrimental to IRI's interests. It is better for IRI to carry out this operation on its own in the immediate future so as to be able to dispose of its shareholding under more advantageous conditions once Alitalia's restructuring is complete. Furthermore, the involvement of private partners in Alitalia's capital at the present stage would make it necessary to devise a long- or medium-term programme which would prevent the company from returning its assets and management to a proper state of balance in 1998 and thus from benefiting fully from the start-up stage of activity at Malpensa airport.

Secondly, as regard the lack of credibility of the restructuring plan, the Italian authorities stress that the assumptions on which the plan are based are not only realistic but also reasonable, since the cost of the capital loans, the traffic forecasts and the cost reductions set out in the plan include a margin of caution. Furthermore, the positive impact of the millennium celebrations at the end of the century has not been taken into consideration. With regard to the coexistence of the two hubs of Malpensa and Fiumicino, the Italian authorities point out that Alitalia already has two airport hubs (Fiumicino and Linate), that it is necessary to improve the company's network by

increasing its traffic on the most important Italian market (northern Italy), that major European companies are successfully operating several hubs, and that the duration of the journey between Malpensa and the centre of Milan would seem to be comparable to that between city centre and airport in other European cities. They also maintain that the increase in Alitalia's traffic on intercontinental routes is compatible with the capacity of its long-haul fleet since, apart from introducing four new long-haul aircraft, the plan provides for agreements with other carriers and for freight business. Lastly, still according to the Italian authorities, the plan reaffirms the trend towards the reduction of labour costs, since Alitalia already has a productivity level which is among the highest in the sector.

Thirdly, with regard to the lack of capacity reduction or the closure of loss-making routes, the Italian authorities explain that the forecasts for Alitalia's growth during the period covered by the plan are still considerably lower than those in the market, despite the business development expected at Malpensa airport. Furthermore, according to the Italian authorities, it is necessary to take account of all of the contributions of each route to the network and, in this respect, the operating margin of the three parts of the company's network (national, international, intercontinental) is positive.

Fourthly, with regard to the claim that the increase in capital is distorting competition, the Italian authorities assert that the commercial inititatives launched by Alitalia during the last few months do not make the company a price leader, are part of the strategy as set out in the plan, and comply with the selectivity criteria (segmentation of demand, feeding of international and intercontinental flights, optimum utilization of aircraft).

Lastly, with regard to the requirements which the Commission should impose, the Italian authorities consider them to be inapplicable since, in their view, the recapitalization of Alitalia does not constitue State aid. They also specify that the imposition of limits on Alitalia's growth would undermine the logic of the plan at a time when the carrier is generally expanding.

V

As was announced in its letter to the Italian authorities of 21 October 1996 initiating the procedure, the Commission has, since November 1996, been calling on the services of an independent consultant (Ernst & Young) to gather information on several of the questions about which it had expressed doubts. The consultant was therefore first of all instructed to apply the principle of the investor operating in a market economy to the operation in question and, with this in mind, to carry out a general assessment of Alitalia's situation, to consider the options available to the company's public shareholder (IRI) and its private shareholders, in particular in the light of the provisions of Article 2447 of the Italian Civil Code, to calculate the internal rate of return of the operation, and to identify more generally all the components of any aid given, including guarantees. In the event of the consultant's concluding on this initial point that the proposed capital injection of Lit 3 000 billion was not consistent with the behaviour of a rational investor, he was also asked, secondly, to evaluate the viability and adequacy of the restructuring plan, to verify whether the amount of Lit 3 000 billion is essential and its suitability for meeting the plan's objectives and, lastly, to try to find alternatives to the capital injection.

The consultant appointed by the Commission was able to perform his task by working in cooperation with the representatives of IRI and Alitalia and by obtaining from them all of the information needed. On 11 December 1996, the consultant sent the Commission the report which concluded the first part of his work. The main points to emerge from the report are that:

— in the light of Alitalia's situation, the Italian Civil Code requires its shareholders to recapitalize the undertaking or to sell off its assets at an early date,

— in view of this situation, the restructuring plan has more the appearance of a turnaround plan than of a business plan. The minimum annual rate of return (hurdle rate) required by an investor in such a situation is between 30 and 40 %,

— the costs of writing off the losses which the IRI group will sustain in the event of Alitalia's bankruptcy following the loans granted to it by other companies in the group are a very important factor in the calculation and the analysis to be made,

— determination of the growth rate of Aliatalia's cash flow after the year 2000 would seem to be fraught with risk, but is also extremely important. While the Italian authorities assume that this rate will be 5,93 %, the consultant assumes a rate of 4 %,

— the early retirement programme provided for Alitalia employees and backed up by funding of some Lit 160 billion from the Italian State budget for the period from 1995 to 2001 might include some components of State aid,

— the internal rate of return on the capital injection of Lit 3 000 billion, as recalculated after adjustment of the information presented by Alitalia, varies between − 12,5 % and + 25,7 % depending on the various scenarios adopted (inclusion or exclusion of insolvency costs or the funding of the early retirement programme, differing assumptions with regard to the growth rate of the cash flow after the year 2000 and the share of Alitalia's capital held by IRI by the year 2000). It is at all events considerably less than the minimum level required, given the risks being taken by the investor.

The consultant's report was sent to the Italian Government on 12 December 1996 for comments. In their comments of 20 December 1996 to the Commission, the Italian authorities expressed little ciriticsm of the consultant's work in overall terms. However, they considered the following four points to be unacceptable or contradictory: fixing the hurdle rate at 30 % or at any higher figure; considering the early retirement programme to be an additional capital injection; the assumption of an average annual growth rate in the cash flow after the year 2000 of only 4 %; exclusion of the insolvency costs from the calculation to be made.

On the basis of all of this information and in particular the report submitted by the consultant, the Commission informed the Italian authorities and Alitalia's management at a meeting in Brussels on 16 January 1997 and by letter of 22 January 1997 that the company's restructuring plan submitted on 29 July 1996 did not appear to be adequate to warrant a positive decision, and that it would be essential to obtain additional information before the changes could be considered necessary. This examination was to be carried out in cooperation with the consultant appointed by the Commission. A technical meeting on this subject was held in Rome on 24 January 1997 between the Commission, Alitalia and their respective consultants.

VI

Following the discussions between the Commission and the Italian authorities in January 1997 and in the light of the comments presented by the Member States and the other parties concerned, the company Alitalia unofficially informed the Commission, in February 1997, of its intention to adjust the restructuring plan notified on 29 July 1996. This adjustment is based on more modest forecasts at both the macro-economic level and as regards the undertaking's own data, in particular the changes in supply and yield. It chiefly includes the following points:

— a reduction, as from 1997, of nearly 10 % in the number of routes and frequencies operated by Alitalia. The total number of flights cancelled would be therefore about 27 000 a year,

— maintaining the fleet at its current level until the end of the restructuring plan: there will be 158 aircraft in service in the year 2000, as compared with 172 initially provided for in the plan and 157 at the end of 1996. This represents a fall of about 16 % in terms of seats available as compared with the initial plan. The number of people to be recruited will therefore be reduced by 476 during the period covered by the plan. In total, the number of Alitalia employees will fall by 1 212 between December 1996 and December 2000,

— a reduction in the total amount of the proposed capital increase, which falls from Lit 3 000 billion to Lit 2 800 billion, owing to less need for investment,

— the disposal of Alitalia's shares in the computerised reservation system Galileo,

— alignment of Alitalia's method for the depreciation of aircraft to that used by the other major Community companies.

In February 1997, the Commission asked its consultant to examine the updating of Alitalia's restructuring plan as described above. On 6 March 1997, the consultant sent the Commission a draft report which was forwarded the same day to the Italian authorities for comment. The draft report took account of Alitalia's known results for 1996. It concludes that, although the updated plan is indeed more cautious than the initial plan and is far less expansionist, it is nevertheless still based on several generous assumptions. The consultant therefore believes that the minimum annual rate of return required by an investor in this situation could not be less than 30 %, since the operation still entails major risks. Again according to the consultant, this rate is still broadly higher than the underlying internal rate of return, although the latter is considerably better as a result of the changes made.

In a document sent to the Commission on 25 March 1997 and by letter of 3 April 1997, the Italian authorities produced comments on the draft report sent to them on 6 March 1997. They challenge several of the points made in the draft report, in particular the supposed generosity of some of the assumptions in the plan and the fixing of the minimum annual rate of return required (hurdle rate) at 30 %. They therefore reaffirm that the investment in question is in conformity with the norm of the investor in a market economy.

Detailed discussions of all of the issues raised by this matter subsequently took place during a meeting between the Commission and its consultant, on the one hand, and Alitalia and its own consultant, on the other, in Brussels on 8 April 1997. In parallel with this meeting, requests for additional information were sent by the Commission on 11 April 1997 to Alitalia and the Italian authorities, to which Alitalia replied by letter of 15 April 1997 and the Italian authorities by letter of 17 April 1997 providing the details and information requested. It was in particular confirmed that IRI would provide the capital injection of Lit 2 800 billion.

By letter of 18 April 1997, the Commission informed Alitalia and the Italian Government that it was not in a position to adopt a positive decision on this matter based on the norm of an investor in a market economy, on account both of the difficulties inherent in taking account of the insolvency costs to be borne by IRI in the event of Alitalia's bankruptcy and of the gravity of the commercial risks which the plan still entails. Following this correspondence, several meetings were held between the Italian authorities and the Commission in Brussels and Rome in May and June 1997.

The meetings enabled the plan to be further improved as regards the following points:

— speeding up the cost reduction by transferring Alitalia employees to Alitalia Team faster than originally planned,

— reducing the amount of the proposed capital increase to Lit 2 750 billion. In addition, the capital increase is now divided into three instalments: the first, amounting to Lit 2 000 billion (including the Lit 1 000 billion granted as an advance in June 1996), to be paid immediately following the adoption of a positive decision; the second, amounting to Lit 500 billion, to be paid in May 1998, the third, amounting to Lit 250 billion, to be paid in May 1999,

— the disposal of shares held by Alitalia in the Hungarian company Malev and in six regional Italian airports (Genoa, Naples, Rimini, Florence, Lamezia Terme and Turin).

The analysis made by the Commission's consultants points to the conclusion that these additional improvements reduce the risks inherent in the restructuring plan and further increase the profitability of the capital injection. In an additional report, the consultant appointed by the Commission also concludes that the plan, as improved and adjusted since January 1997, is realistic and will allow Alitalia to return to a satisfactory level of profitability by the year 2000. The consultant adds that the amount of the capita injection may be regarded as essential and adequate to meet the plan's objectives and the needs generated by the restructuring effort.

On 26 June 1997, the Italian authorities officially sent the Commission all of the information on the adjustment of the plan referred to above. The adjusted plan, which has been discussed with the company's trade unions, includes economic and financial forecasts corrected in the light of this information and the known results for 1996. The main figures and ratios in the adjusted plan are as follows:

	1996	1997	1998	1999	2000
Turnover	7 834	7 966	8 232	8 674	9 167
Operating result	− 24	165	438	718	929
Net result	− 1 291	175	294	487	649
Net debt (including leasing and 'TFR' retirements funds)	4 268	3 077	3 289	3 180	3 319
ATK	7 118	7 014	7 197	7 496	7 724
Number of employees (as at 31. 12)	17 390	16 677	15 934	16 044	16 178
Number of aircraft	157	143	148	153	158
Investments	—	443	983	1 097	1 202

	1997	1998	1999	2000
Financial ratios				
Operating result / Turnover	2,1 %	5,3 %	8,3 %	10,1 %
Debt (gearing) (1) / Equity	2,1	1,6	1,2	1,1
Productivity ratio				
ATK / Number of employees	425	452	467	477
Cost ratios				
Operating costs (2) / ATK	1 077	1 022	979	963
Staff expenditure / Operating costs	23,7 %	22,9 %	22,6 %	22,0 %
Cabine crew / Operating costs	5,5 %	5,2 %	5,0 %	4,5 %
Cockpit crew / Operating costs	6,4 %	6,3 %	6,2 %	6,2 %

(1) The debt includes the non-reimbursed capital relating to the financial leasing and the special provision ('TFR') for severance payments to employees.

(2) In constant lira for 1996.

In their letter of 26 June 1997, the Italian authorities also acknowledge that the financial section of the adjusted plan is a State aid measure within the meaning of the Treaty and they give several undertakings. The Italian authorities have therefore undertaken:

1. to adopt the behaviour of a normal shareholder towards Alitalia; to enable it to be managed in accordance with commercial principles only and not to become involved in its management for reasons other than those strictly related to the Italian State's status as a shareholder;

2. not to grant Alitalia any further capital payment or any other aid in any form, including loan guarantees;

3. that, until 31 December 2000, the aid will be used by Alitalia solely for the purposes of restructuring the company and not for acquiring new shareholdings in other air carriers;

4. not to give Alitalia priority in any way over other Community companies, in particular as regards the allocation of traffic rights (including those relating to third countries in the European Economic Area), slot allocation, ground-handling assistance and access to airport facilities where preferential treatment would be contrary to Community law. In particular, the Italian authorities confirm that they will not apply any measure that is contrary to Community law and guarantee that:

   (a) they will immediately start and by 31 December 1998 at the latest will complete the revision of Agreement No 4372 of 15 April 1992 (hereinafter 'the Agreement'), as approved by Decree of 16 April 1992, in order to bring the Agreement into conformity with Communtiy regulations, in particular as regards the 'right of priority', 'government interference', 'compatibility with the regulations on the liberalization of air transport' and 'airport privileges';

   (b) a *'de facto'* revision of the Agreement has already taken place with regard to the above points following the exchange of letters with Alitalia on the basis of Article 50 of the Agreement, the exchange making it clear that the Agreement applies only if it is compatible with Community law;

   (c) Alitalia renounces its right of priority pursuant to Article 3 of the above Agreement;

   (d) in coordinated or fully coordinated Italian airports, it will, before the start of the 1997-98 winter season, appoint a coordinator who does not have any link whatsoever with Alitalia and acts completely independently of it;

5. that, until 31 December 2000, the capacity available on aircraft operated by Alitalia or other carriers in such a way that it poses a commercial risk to Alitalia (wet leasing, block space, joint venture agreements, etc.) will not exceed the following limits:

   (a) the number of seats available will not exceed 28 985, of which 26 350 will be for Alitalia's own fleet;

   (b) the increase in the number of seat-kilometres available for each calendar year

   — within the European Economic Area excluding Italy, and

   — within Italy

   will not exceed 2,7 %, on the understanding that no growth will be authorized if the growth in the corresponding markets remains lower than 2,7 %. However, if the growth rate in the corresponding markets exceeds 5 %, supply may be increased, above 2,7 %, by the percentage of the increase beyond 5 %.

6. that Alitalia will have an analytical accounting system that makes it possible to determine, in the short term and for each route, a profitability ratio defined as the ratio between the full revenue and the full costs (the full cost equivalent to the sum of the variable costs and fixed costs) for the particular route;

7. that, until 31 December 2000, Alitalia will refrain from offering fares lower than those offered by its competitors for an equivalent service supplied on the routes which it operates;

8. that Alitalia will dispose of its shareholding in Malev by [...](6) at the latest;

9. that Alitalia will continue with the full implementation of the restructuring plan notified to the Commission on 29 July 1996 and adjusted on 26 June 1997, in particular as regards meeting the objectives in terms of productivity, profitability and financial restructuring;

(6) Business secret.

10. to submit to the Commission, by the end of March 1998, March 1999, March 2000 and March 2001, an annual report on the progress of the restructuring plan, Alitalia's economic and financial situation, and the compliance with these requirements. The report will include a description (giving the particulars of co-contractors) of the commercial or operational cooperation agreements concluded by Alitalia during the previous year. The Commission will, if necessary, have the information given in each of the reports checked by an independent consultant chosen by the Commission in agreement with the Italian Government.

The Italian authorities also point out that the payment of the second and third instalments of the capital increase, in May 1998 and May 1999 respectively, is subject to compliance with the above commitments, the actual implementation of the restructuring plan and achievement of the expected results (in particular as regards the above cost and productivity ratios). At least ten weeks before the release of the last two instalments, they will submit a report to the Commission to enable it to express comments with the assistance of an independent consultant, selected by the Commission after consultation with the Italian authorities.

In their letter of 26 June 1997, the Italian authorities also indicated that they had abandoned the draft Law providing for the funding by the Italian State of the modernization of the MD 80 aeroplanes and that the company's headquarters building at Magliana would be transferred by Alitalia at the market rate.

Lastly, in their correspondence of 26 June 1997, the Italian authorities refer to DL No 546/96 on the early retirement of 700 Alitalia employees between 1995 and 1997. The Decree Law provides for the payment of an additional monthly allowance until the employees concerned reach normal retirement age. The total budget for this measure is estimated at Lit 160 billion for the entire period from 1995 to 2001, of which Lit 56,6 billion is for the period from 1995 to 1997 alone.

The Commission notes that the Italian authorities pointed out, in the same correspondence, that, by 5 July 1997, Alitalia had undertaken irrevocably to pay the sum of Lit 56,6 billion, plus interest, into a blocked account in the name of a notary public for the purpose of reimbursing the Italian State. With regard to the remaining amounts, the Italian authorities have indicated that, by the end of June each year until 2001, Alitalia will pay the sums owing to the employees concerned for each of the years in question into the same account.

In the light of the factual information summarized above, the Commission is in a position to make a final assessment in this case.

LEGAL ASSESSMENT

VII

Under the terms of Article 92 (1) of the Treaty and Article 61 (1) of the Agreement on the European Economic Area (hereinafter referred to as 'the Agreement'), 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 incompatible with the common market and with the Agreement.

In this case, it is important to assess, in the light of those provisions, the capital injection totalling Lit 2 750 billion which the State holding company IRI proposes to put into Alitalia in accordance with the plan notified to the Commission.

First of all, there is no doubt whatsoever that this capital injection constitutes State resources within the meaning of the abovementioned provisions. Indeed, the funds concerned come specifically from the Italian Treasury and the decision to increase the capital was taken by the Italian authorities, as in the case examined by the Court of Justice in its judgment of 21 March 1991 in Case C-305/89 Italy v. Commission (7).

Regarding the presence of any aid components, the Treaty and the Agreement lay down the principle of neutrality *vis-à-vis* Member States' rules governing the system of property ownership (Article 222 of the Treaty and Article 125 of the Agreement) and the principle of equality between public and private enterprises. Consequently, Commission action may be neither prejudicial nor beneficial to public enterprises, for example when it is examining an operation in the light of the abovementioned provisions of Article 92 of the Treaty and Article 61 of the Agreement. It is therefore necessary to establish on a case-by-case basis whether a transaction between a Member State and a public enterprise constitutes a normal commercial transaction or whether, in whole or in part, it contains any aid components.

(7) [1991] ECR I-1603, points 11 to 16.

In order to do this, the Commission must base its judgment on the principle of the investor operating in a market economy. Under this principle, no State aid is deemed to be involved where a State provides funds in a manner which would be acceptable to a private investor operating under normal market economy conditions ([8]). In general, the Commission considers that the provision of capital from public funds is not State aid provided private shareholders participate in the operation in proportion to their number of shares and under conditions identical to those for the public investor. However, the private investor's holding must have real economic significance. In the present case, however, even it is presumed that the 10 % share of Alitalia's capital held by private investors may be deemed to have real economic significance, no private investor is taking part in the capital increase of Lit 2 750 billion. Furthermore, employee participation in the company's capital to the amount of Lit 310 billion, as set out in the agreement of 19 June 1996, cannot be taken into consideration since the conditions under which this works are very different.

Thus, in the absence of substantial participation by private investors in the operation in question, the Commission must have recourse to a more theoretical approach, the rules of which have been explained several times by the Commission and the Court of Justice. The Court has thus held, in its above judgment of 21 March 1991 in Case C-305/89, that it is necessary 'to consider whether in similar circumstances a private investor of a size comparable to that of the bodies administering the public sector might have provided capital of such an amount' ([9]), and further, that 'although the conduct of a private investor with which the intervention of the public investor pursuing economic policy aims must be compared need not be the conduct of an ordinary investor laying out capital with a view to realizing a profit in the relatively short term, it must at least be the conduct of a private holding company or a private group of undertakings pursuing a structural policy — whether general or sectoral — and guided by the prospects of profitability in the longer term' ([10]). Where the undertaking is loss-making, the long-term investor will take his decision in the light in partiular of the existence of a consistent and adequate restructuring plan.

The method normally used to measure the rational nature of an investment consists in comparing the amount of the investment to the amount of revenue it will generate. In this particular case, the deadline to be taken for the comparison is the year 2 000, in which the plan will be completed. The revenue generated by Alitalia includes the dividends which will be paid to IRI by Alitalia by the year 2 000 and in particular the increase in value of the company by the year 2 000. This increase in value is in fact equivalent to the value of IRI's shareholding in the company at that date, since Alitalia's present value is zero according to the specialists consulted. The Commission believes in this respect that, in the present circumstances, it is not necessary to include, in the expected revenue, the costs which IRI will have to bear in the event of Alitalia's bankruptcy. Indeed, these insolvency costs are for the most part due to the loss of short-term loans granted to Alitalia by the financial company Cofiri, a subsidiary of IRI, before June 1996. They have been repaid since June and July 1996 through the payment, at the same time as the advance, of a sum of Lit 1 000 billion, which in practice also enables this double operation to be regarded as a conversion of capital loans. However, a private investor guided by the prospects of profitability in the longer term would not base his decision on the consideration of a possible immediate advantage if the company's true situation was not sufficiently good to justify long-term commitments.

On the basis of the information in the Commision's possession, the internal rate of return for IRI on the investment of Lit 2 750 billion in Alitalia's capital is close to 20 %, bearing in mind that the early retirement costs are being directly met by Alitalia. This internal rate of return is still below the minimum annual rate of return (hurdle rate) which an investor acting in accordance with the laws of the market would demand before injecting the capital concerned. In view of this, the Commission believes that the criterion of an investor in a market economy is not met in this case.

Furthermore, the capital injection in question affects trade between the Member States since it involves a company whose transport activity, which by its nature directly affects trade, covers the whole of the common market and the European Economic Area. It also distorts or threatens to distort competition within that market, since it is directed at just one company which is in competition with other Community companies over most of its European network, in particular since the entry into force of the third package of air-transport liberalization measures on 1 January 1993. Indeed, it constitutes State aid within the meaning of Article 92 (1) of the Treaty and Article 61

([8]) Commission Communication on the application of Articles 92 and 93 of the Treaty to public authorities' holdings, *Bulletin of the European Communities* 9-1984; Judgment of the Court of Justice in Joined Cases 296 and 318/82 *Netherlands and Leeuwarder Papierwarenfabriek BV* v. *Commission*, [1985] ECR 809, paragraph 17; application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector, paragraphs 25 and 26.

([9]) See footnote 8; paragraph 19.

([10]) Paragraph 20.

(1) of the EEA Agreement, as the Italian authorities moreover explicitly acknowledged in their correspondence of 26 June 1997. It is therefore necessary to examine the possible compatibility of this aid with Article 92 (2) and (3) of the Treaty and Article 61 (2) and (3) of the Agreement.

VIII

Article 92 (2) (a), (b) and (c) of the Treaty and Article 61 (2) (a), (b) and (c) of the EEA Agreement do not apply to the operation in question since it is neither aid having a social character granted to individual consumers, nor aid to make good the damage caused by natural disasters or exceptional occurrences, nor aid granted to the economy of certain areas of Germany.

Article 92 (3) of the Treaty and Article 61 (3) of the EEA Agreement list the types of aid which may be considered to be compatible with the common market. Such compatibility must be assessed in the context of the entire Community and not simply that of a single Member State. Moreover, in order to safeguard the proper functioning of the common market, and having regard to the principles of Article 3 (g) of the Treaty, the derogations from Article 92 (1), as defined in Article 92 (3), must be interpreted strictly when examining an aid scheme or any individual measures, especially since, in view of the increase in competition resulting from the liberalization of air transport following the third package of measures, the Commission must be strict in its policy on monitoring State aid so as to prevent it from having effects which are contrary to the common interest.

Article 92 (3) (a) and (c) of the Treaty and Article 61 (3) (a) and (c) of the EEA Agreement lay down derogations for aid to promote or facilitate the development of certain areas. The capital injection into Alitalia does not seem to qualify for application of these provisions since it is an *ad hoc* measure designed to solve a specific problem and does not form part of a general scheme or benefit to all Italian air carriers. Indeed, the Italian Government has not cited these heads of exemption.

Article 92 (3) (b) and (d) of the Treaty and Article 61 (3) (b) and (d) of the Agreement are also inapplicable in this case because the measure in question is not designed to promote the execution of a project of common European interest, to remedy a serious disturbance in the economy of a Member State, or to promote the culture or conservation of European heritage.

As for the derogation in Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement in respect of aid to facilitate the development of certain economic activites where such aid does not adversely affect trading conditions to an extent contrary to the common interest, the Commission may consider aid for the restructuring of a company to be compatible with the common market if it meets a number of conditions [11], which can be summarized as follows:

— the aid must form part of a comprehensive restructuring programme aimed at improving the financial health of the company so that it can, within a reasonable period, become viable and competitive in the environment in which it is operating,

— the programme must be self-contained, which means that no further aid will be necessary,

— the programme must include capacity reductions, if required by the market situation or for the company to return to profitability,

— the aid must not result in the transfer of the company's problems to its competitors,

— the government must refrain from interfering in the management of the company for reasons other than those stemming from its ownership rights and must allow the company to be run according to commercial principles,

— the aid must be used exclusively for the purposes of the restructuring programme and must not be disproportionate to its needs,

— the aid must not infringe other Treaty provisions,

— the aid must be so structured that it is transparent and capable of being monitored.

The Commission has verified that the capital increase of Lit 2 750 billion for Alitalia meets these various criteria, having regard in particular to all of the factual information summarized in Parts I to IV above.

With regard, firstly, to the company's viability over time, it should be pointed out that the capital increase in question accompanies a restructuring plan to whose full implementation the Italian authorities have commited themselves, by letter of 26 June 1997. The plan has been the subject of consultations with the company's trade unions. Its aim is to restore Alitalia's competitiveness and to enable it to be privatized in the new context of the liberalized Community market. With this dual objective in mind, the capital increase will substantially reduce the company's debt and help it to return to a financial structure comparable to that of most of its competitors. Restructuring the balance sheet liabilities will also substantially reduce the financial expenses. Furthermore, the plan provides for the continuation of the efforts already made by Alitalia with regard to productivity and costs. Moreover, the Commission notes than the productivity level of the company's staff is currently the same as that of its main Community competitors. With regard to

[11] Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector, cited above (footnote 2).

production costs, the handicap from which Alitalia is still suffering in this respect should progressively decline during the period covered by the plan as a result in particular of the staff reduction and the transfer of company staff to Alitalia Team. The cost and productivity ratios set out in paragraph VI above, which the Italian authorities have undertaken to abide by during the period covered by the plan, also testify to the progress which will be made.

Furthermore, the plan as adjusted on 26 June 1997 limits the company's growth during the next four years. It is aimed at obtaining operating results that are broadly in surplus, not by means of an expansionist policy, but mainly by reducing costs with production capacities practically unchanged during the period covered by the plan and initially even considerably reduced. Like most competitor companies which had to cope with the crisis in air transport in the early 90s, Alitalia is also pursuing a policy of refocusing its activities on its core business, namely air transport itself. Therefore, following the disposal of the the shares in the capital of Società Aeroporti di Roma in 1995, the plan provides in particular for the forthcoming sale of the headquarters building at Magliana and of Alitalia's shareholdings in Alfa Romeo Avio, SISAM, the computerized reservation system Galileo, Malev and six regional Italian airports.

On this basis, the extremely positive results expected by the year 2000 should both meet the company's needs in terms of working capital and funding of investments essential for long-term business and open up the prospect of long-term viability. They should also inspire confidence in investors and pave the way for the development of alliances with other companies.

Lastly, with regard to Alitalia's ability to return to profitability, the Commission has noted the undertaking given by the Italian authorities in their letter of 26 June 1997 not to give Alitalia priority in any way over other Community companies and the aim constantly advanced by the Italian Government of proceeding as soon as possible with the company's privatization. The Commission would stress in this respect that the maintenance of a protected situation with regard to Alitalia would, on the contrary, cause it to doubt the Italian authorities' conviction that the company is able to prosper in the competitive environment which now characterises the Community civil aviation market.

Secondly, the Commission has assured itself, with the help of its consultants, that the plan was in itself sufficient to guarantee Alitalia's survival and prosperity without the need for any additional aid. Furthermore, the Italian authorities undertook in their letter of 26 June 1997 not to grant any further aid to Alitalia in any form whatsoever, including explicit or implicit loan guarantees. In this connection, the Commission would point out that it would regard any guarantee of payment explicity or implicitly granted to Alitalia's creditors by IRI or any other public body as unlawful State aid because it had not been notified ([12]). The Commission has also noted that the Italian Government has abandoned the plan to provide funding for a programme to modernize the MD 80 aircraft and that the headquarters building at Magliana will be sold at the market price.

Thirdly, the plan as adjusted includes the capacity reductions needed to return the company to profitability. Thus, the number of aircraft and seats available in all the aircraft operated by Alitalia will increase from 157 and 25 422 respectively, in 1996, to 143 and 23 384 in 1997. The total number of available tonne-kilometres will fall by 1,5 % between 1996 and 1997. The adjusted plan also provides for the abandonment of routes and frequencies amounting to a total of 27 000 flights a year as from 1997 — about 10 % of the total flights operated by Alitalia. These capacity reductions are all the more significant given that the European civil aviation market is currently growing by an annual average of about 6 % a year. The Commission has also taken note of the Italian authorities' undertakings to limit considerably the company's available capacity up to the year 2 000. As indicated above, these capacity reductions followed by a considerable restriction in the company's growth, as provided for in the plan itself, strengthen the credibility of the plan since most of the efforts aimed at restructuring and returning to profitability are based on the reduction of production costs.

Fourthly, the Commission has taken all necessary steps to ensure that the aid received by Alitalia will not shift the company's difficulties to its Community competitors. On this point, it is chiefly important to note that the adjusted plan provides for the continuous diminution of Alitalia's market share throughout the duration of the plan, on the national, international and intercontinental routes operated by the company. In addition, air transport in Europe is currently enjoying high rates of growth in excess of 6 % a year and the prospects are just as good for

([12]) See the letter sent by the Commission to the Member States on 5 April 1989.

the coming years. This general context of sustained growth offers better prospects for competitors than if demand were low. Moreover, in their letter of 26 June 1997, the Italian authorities gave an undertaking that Alitalia's production capacity would be limited in several ways in conformity with the plan. For example, the number of seats available throughout the fleet operated by Alitalia proper may not exceed 26 350 before the end of the year 2 000. This restriction covers all of the network operated by Alitalia. Similarly, the growth in the number of seat-kilometres available by Alitalia within Italy and the European Economic Area will be limited to a level lower than market growth. On top of these restrictions on quantities supplied, Alitalia's freedom with regard to fares is limited since the Italian authorities have also pledged that, during the period covered by the plan, Alitalia may not adopt the behaviour of a price leader by offering fares lower than those of its competitors for an equivalent service on the routes it operates. Consequently, the plan should not increase Alitalia's business to the detriment of the other Community carriers.

Furthermore, the Commission has assured itself that the grant of the aid in question, which will help Alitalia to survive and to stay in business, will not constitute an obstacle to the opening-up of the Italian market and the development of competition within the European Economic Area, especially as regards companies other than Alitalia which are licensed in Italy. The Italian authorities also gave an undertaking, in their abovementioned correspondence of 26 June 1997, not to give Alitalia any form of priority over the other Community companies, in particular as regards the allocation of traffic rights, slot allocation, ground-handling services and access to airport facilities. This principle of non-discrimination will also apply to the application or amendment of rules for the distribution of traffic within the same airport system. It will result, *inter alia*, in the abolition of the preferential rights granted to Alitalia by the Decree of 16 April 1992 approving the Agreement: this Agreement already included a clause confirming the primacy of Community law, but will now be formally brought into line with Community law. With regard to the allocation of traffic rights to third countries, and in particular the immediate non-application of the priority right pursuant to Article 3 of the Agreement, the Italian authorities will now make single designations or multiple designations to these countries simply on the basis of the individual merits of each application for traffic rights. This will also lead to the designation, in the coordinated Italian airports, of a coordinator who will act in total independence and without any links with Alitalia, in particular without any organizational, legal or technical links. If this were not done, the maintenance of a protected situation for Alitalia would amplify the negative effect of the aid and would thus itself be contrary to the common interest within the meaning of Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the Agreement.

Fifthly, the Italian authorities have given an undertaking, in their letter of 26 June 1997, to adopt the behaviour of a normal shareholder toward Alitalia and not to interfere in its management for reasons other than those strictly related to the Italian State's status as a shareholder. This undertaking will enable Alitalia to be managed in accordance solely with commercial principles in the liberalized Community civil aviation market, which the Commission regards as a determining factor for the plan's success. The Italian Government therefore makes a clear distinction between the State's role as as shareholder in a company, the main motivation for which must be to maximise financial profits, and the State's role as a public authority, which is motivated by general policy concerns. The above undertaking by the Italian authorities to consider Alitalia henceforth as an ordinary company in regulatory terms and not to give it any preferential treatment also forms part of this distinction.

Sixthly, the Commission believes that the aid will be exclusively used for the purposes set out in the plan and that it is not disproportionate in relation to the requirements of the plan. The total amount of Lit 2 750 billion is indeed necessary to cover both the costs of the restructuring proposed in the plan, which is estimated at Lit 900 billion, and to reduce the company's debt, which was Lit 3 420 billion at the end of 1995 as compared with Lit 422 billion in own capital, to a reasonable level. As stated above, the debt reduction would seem to be essential for the company's recovery, as it its important to restructure the balance-sheet liabilities and to reduce the amount of the financial expenses, which represented 5,3 % of turnover in 1995. With regard more specifically to the structure of the balance-sheet liabilities, the aid will not lead to the overcapitalization of Alitalia. Examination of the changes in Alitalia's gearing (the ratio of debt to own funds) during the period covered by the plan with the leasing operations included in or excluded from the gearing, shows that the value of the gearing will remain comparable to that of the main European and US competitor companies. By refocusing its activities on its core business and shedding a large amount of its investment, Alitalia is helping to cover the financial needs from its own resources.

Furthermore, the aid will not enable Alitalia to adopt an investment policy that is disproportionate or unrelated to the plan. The investment in aircraft proposed in the adjusted plan therefore simply ensures the replacement of the oldest aircraft in the fleet, since the number of aircraft operated by Alitalia will increase to 158 at the end of the year 2000 as compared with 157 at the end of 1996. In addition, the Italian authorities gave an undertaking, in their correspondence of 26 June 1997, that the aid will be exclusively used by Alitalia for the purposes of restructuring and not to acquire new shareholdings in other air carriers. However, the Commission reserves the right to authorize cross-holdings should Alitalia wish to enter into alliance agreements with other companies.

The resources provided by the aid would also seem to be necessary since Alitalia is unable to substitute sufficient resources from the sale of assets. As indicated above, the company has already embarked on a policy of disinvestment and refocusing on its core business. However, although the resources of about 600 billion thus released will make it possible to reduce the capital increase to be made, they are out of all proportion to the financial requirements of the plan. The company would, moreover, be unable to dispose of assets relating to its main activities without compromising the plan's success.

Seventhly, it does not emerge from the information in the Commission's possession that the grant of the aid will produce a result that would be contrary to the specific provisions of the Treaty and, more especially, the other provisions of the Treaty which are also concerned with the objective of undistorted competition in the common market ([13]). On the contrary, as already mentioned above, the Italian authorities have agreed to abolish any discriminatory treatment in favour of Alitalia. Furthermore, the restrictions which the Italian authorities have also undertaken to have respected as regards prices and quantities offered by Alitalia during the period covered by the plan greatly limit the risk that the aid recipient may resort to predatory practices contrary to the provisions of Article 85 and 86 of the Treaty. The commitments given by the Italian authorities, whereby Alitalia will not acquire new shareholdings in other air carriers, will have an analytical accounting system that makes it possible to determine, in the short term, a profitability ratio for each route operated and will give details in an annual report of cooperation agreements concluded with other airlines, go in the same direction. On the last-named point, the Commission will check very closely the agreements which Alitalia may be called on to conclude during the period covered by the plan with the companies Eurofly and Air Europe, in whose capital it already has a shareholding.

Eighthly, with regard to the transparency and verifiable nature of the aid, it should be first of all be pointed out that the Italian authorities have provided the Commission with all the information it had requested in order to be in a position to give an opinion on this case in full knowledge of the facts. Similarly, the consultant appointed by the Commission has been able to have access to all the information needed to fulfil his task properly and to work in cooperation with the representatives of IRI and Alitalia. Moreover, the undertakings given by the Italian authorities on 26 June 1997 as regards the follow up to the plan submitted to the Commission guarantee satisfactory scope for verification and control: the Italian Government will ensure the full implementation of the restructuring plan; it will submit a report on this implementation and the fulfilment of its commitments each year to the Commission until the plan expires; the Commission will be able to have the report checked by a consultant selected in agreement with the Italian Government; the Italian authorities will not pay the second and third instalments of the capital increase in May 1998 and May 1999 if the plan's objectives are not met or if the commitments have not been fulfilled.

Lastly, in general terms and with regard to the Community interest, the Commission believes that the recapitalization and restructuring of Alitalia will contribute to the development of business in the air transport sector within the Community and the European Economic Area since, in particular, Alitalia would seem to be the main carrier in a significant part of the Community and the existence of several large Community airlines guarantees the maintenance of a balanced competitive situation.

IX

The considerations set out in parts VII and VIII above address the concerns expressed by the Commission in its decision of 9 October 1996 to initiate the procedure and by the Member States and interested third parties in the comments they have subsequently produced.

In the light of the foregoing, the aid granted by the Italian Government to Alitalia in the form of a capital injection totalling Lit 2 750 billion accompanying the company's restructuring plan is eligible for the exemption provided for in Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the Agreement provided that several conditions are met to ensure that the aid in question facilitates the development of the air transport sector and does not adversely affect the conditions of trade to an

([13]) See judgment of the Court of 15 June 1993 in Case C-255/91, Matra SA v. Commission, [1993] ECR I-3203, paragraphs 41 *et seq.*

extent contrary to the common interest. However, the Commission regrets the fact that the Italian Government granted an advance of Lit 1 000 billion to Alitalia in June 1996, to be set against the first instalment of Lit 2 000 billion, before the adoption of the final decision and in disregard of Article 93 (3) of the Treaty,

HAS ADOPTED THIS DECISION:

Article 1

The aid granted by Italy to the company called Alitalia Linee Aeree Italiane S.p.A. (hereinafter: 'Alitalia') in the form of a capital injection totalling Lit 2 750 billion for the restructuring of the company in conformity with the plan notified to the Commission on 29 July 1996 and adjusted on 26 June 1997 is deemed to be compatible with the common market and the EEA Agreement pursuant to Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the Agreement provided that Italy fulfils the following undertakings:

1. to adopt the behaviour of a normal shareholder towards Alitalia; to enable it to be managed in accordance with commercial principles only and not to become involved in its management for reasons other than those strictly related to the Italian State's status as a shareholder;

2. not to grant Alitalia any further capital payment or any other aid in any form, including loan guarantees;

3. that, until 31 December 2000, the aid shall be used by Alitalia solely for the purposes of restructuring the company and not for acquiring new shareholdings in other air carriers;

4. not to give Alitalia priority in any way over other Community companies, in particular as regards the allocation of traffic rights (including those for third countries in the European Economic Area), slot allocation, ground-handling assistance and access to airport facilities where preferential treatment would be contrary to Community law.

   In particular, Italy confirms that it will not apply any measure that is contrary to Community law and guarantees that:

   (a) it shall immediately start and by 31 December 1998 at the latest shall have completed the procedure of revising Agreement No 4372 of 15 April 1992, as approved by Decree of 16 April 1992 (hereinafter: 'the Agreement'), in order to bring that Agreement into line with Community regulations, in particular as regards the 'right of priority', 'government interference', 'compatibility with the regulations on the liberalization of air transport' and 'airport privileges';

   (b) a *de facto* revision of the Agreement has already taken place with regard to the above points following the exchange of letters with Alitalia on the basis of Article 50 of the Agreement, the exchange making it clear that the Agreement applies only if it is compatible with Community law;

   (c) Alitalia renounces its right of priority pursuant to Article 3 of the above Agreement;

   (d) in coordinated or fully-coordinated Italian airports, it will, before the start of the 1997-98 winter season, appoint a coordinator who does not have any link whatsoever with Alitalia and acts completely independently of it;

5. until 31 December 2000 the available capacity of aircraft operated by Alitalia or by other carriers under agreements whereby Alitalia assumes the commercial risk for such capacity (wet-leasing, block-space, joint venture agreements, etc.) shall not exceed the following limits:

   (a) the number of seats available shall not exceed 28 985, of which 26 350 shall be for Alitalia's own fleet;

   (b) the increase in the number of available seat-kilometres for each calendar year

   — within the European Economic Area excluding Italy, and

   — within Italy

   shall not exceed 2,7 %, on the understanding that no growth is to be authorized if the growth in the corresponding markets remains lower than 2,7 %. However, if the growth rate in the corresponding markets exceeds 5 %, supply may be increased above 2,7 %, by the margin of the increase beyond 5 %;

6. Alitalia shall have an analytical accounting system that makes it possible to determine, in the short term and for each route, the profitability ratio defined as the ratio between the full revenue and the full costs (the full cost being equivalent to the sum of the variable costs and fixed costs) for the particular route;

7. until 31 December 2000 Alitalia shall refrain from offering fares lower than those offered by its competitors for an equivalent service supplied on the routes which it operates;

8. Alitalia shall dispose of its shareholding in Malev by [. . .] [14] at the latest;

9. Alitalia shall continue with the full implementation of the restructuring plan notified to the Commission on 29 July 1996 and adjusted on 26 June 1997, in particular as regards meeting the productivity, profitability and financial restructuring objectives set out in paragraph VI above;

10. to submit to the Commission, by the end of the months of March 1998, March 1999, March 2000 and March 2001, an annual report on the progress of the restructuring plan, Alitalia's economic and financial situation, and the compliance with these requirements. The report shall include a description (giving the particulars of co-contractors) of the commercial or operational cooperation agreements concluded by Alitalia during the previous year. The Commission shall, if necessary, have the information given in each of the reports checked by an independent consultant chosen by the Commission in agreement with the Italian Government.

Article 2

The payment of a second instalment of Lit 500 billion and a third instalment of Lit 250 billion shall be subject to compliance with the commitments under Article 1 and the actual implementation of the restructuring plan and achievement of the expected results (in particular as regards the cost and productivity ratios set out in paragraph VI above).

At least 10 weeks before the release of the second and third instalments, planned for May 1998 and May 1999 respectively, Italy shall submit a report to the Commission to enable it to express comments with the assistance of an independent consultant chosen by the Commission after consulting the Italian authorities. The instalments shall not be released if the objectives of the restructuring plan are not met or if the undertakings are not met.

Article 3

The undertakings and requirements set out in Article 1 shall bind both the company Alitalia Linee Aeree Italiane S.p.A. and its subsidiary Alitalia Team.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 15 July 1997.

For the Commission

Neil KINNOCK

Member of the Commission

[14] Business secret.