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COMMISSION DECISION

of 18 July 2001

concerning the recapitalisation of the company Alitalia

(notified under document number C(2001) 2349)

(Only the Italian text is authentic)

(Text with EEA relevance)

(2001/723/EC)

(OJ L 271, 12.10.2001, p. 28)

Corrected by:

►**C1** Corrigendum, OJ L 90, 8.4.2003, p. 54 (2001/723/EC)

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(2001/723/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first paragraph of Article 88(2) thereof,

Having regard to the Agreement establishing the European Economic Area, and in particular Article 62(1)(a) and Protocol No 27 thereof,

Having regard to Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ([1]),

Having given the parties concerned notice, in accordance with the provisions of the aforementioned Articles, to submit their observations, and having regard to these observations,

Whereas:

THE FACTS

(1) By Decision 97/789/EC ([2]) (hereinafter referred to as the '1997 Decision'), the Commission authorised the Italian authorities to grant State aid for restructuring in the form of a capital injection totalling ITL 2 750 billion to the Italian company Alitalia Linee Aeree Italiane SpA (hereinafter referred to as 'Alitalia'). The aid was intended to support a restructuring plan (hereinafter referred to as the 'plan') which was completed on 31 December 2000. Articles 1, 2 and 3 of the Decision state:

'Article 1

The aid granted by Italy to the company called Alitalia Linee Aeree Italiane SpA (hereinafter: Alitalia), in the form of a capital injection totalling ITL 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

([1]) OJ L 83, 27.3.1999, p. 1.
([2]) OJ L 322, 25.11.1997, p. 44.

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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 liberalisation 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 authorised 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 a 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 […] (*) 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;

(*) Business secret.

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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 ITL 500 billion and a third instalment of ITL 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).

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 SpA and its subsidiary Alitalia Team.'

(2) The 1997 Decision was challenged by Alitalia, which brought Case T-296/97 before the Court of First Instance. In its judgment of 12 December 2000, the Court of First Instance ruled on the case and annulled the 1997 decision. The Court of First Instance gave the following reason for its judgment (point 171):

'Having regard to the failure to state reasons established in paragraph 137 above and to the manifest errors of assessment established in points 150 and 169 above, the Court must grant the form of order sought by the applicant and annul the contested decision, without its being necessary to adjudicate on the other arguments relating to the first plea and on the other pleas in the application.'

(3) The three reasons for annulling the 1997 decision are all related to the second part of the first plea in law put forward by Alitalia. The first plea refers to the misapplication of the principle of a private investor in a market economy. Alitalia submitted to the Court that in the 1997 decision the Commission erred in classifying the capital injection of ITL 2 750 billion into Alitalia by IRI, the Italian State finance company, as State aid. The plea consisted of three parts. In the first part, which was rejected by the Court of First Instance in point 94 of the judgment, the applicant, Alitalia, claimed that IRI's investment in itself satisfied the private investor test because private investors have participated in its capital. In the second part, Alitalia maintained that the Commission made manifest errors of appreciation in calculating the minimum rate and the internal rate, thus infringing Article 92(1) of the Treaty and the principle of equal treatment, and that it did not provide an adequate statement of the reasons for its decision in that respect. In the third part, which the Court did not take into consideration, Alitalia criticised the purely mathematical approach taken by the Commission to the private investor test.

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(4) In examining the second part of the first plea in law, the Court in the first instance examined the method which the Commission had employed in the 1997 decision to determine whether IRI's investment satisfied the private investor test, namely comparing the internal rate of return with the minimum rate which a private investor would require, and found that the method which the Commission employed in the contested decision could not be criticised as such (point 99 of the judgment). The Court rejected the claims brought by Alitalia with regard to the factors taken into consideration by the Commission and its consultants when establishing the minimum rate (points 115 and 123 of the judgment). It then ruled that the 1997 decision was vitiated:

— by an error of reasoning 'in so far as it adopts for IRI's investment the same minimum rate as that determined in the Iberia Decision', Commission Decision 96/278/EC of 31 January 1996 ([1]) (point 137 of the judgment);

— by a manifest error of assessment 'in considering, on the basis of the reasons put forward in the contested decision, that the insolvency costs relating to the loans granted by Cofiri should be excluded from the calculation of the internal rate' (point 150); and

— by a manifest error of assessment 'in considering that the adjustments made to the restructuring plan in June 1997, which, on its own admission, reduced the risks inherent in that plan and further increased the profitability of the undertaking, had no impact on the calculation of the minimum rate and the internal rate and, accordingly, on the appraisal of whether IRI's investment satisfied the private investor test' (point 169 of the judgment).

(5) Firstly, to be more precise with regard to the error of reasoning identified in point 137 of the judgment, the Court referred to the factors which the Commission had taken into consideration when determining the minimum rate of 30 % in the Iberia decision and pointed out that 'the Iberia decision was clearly a suitable precedent for the calculation of the minimum rate in the present case' (point 130 of the judgment) on the grounds that, at the time when the 1997 decision was adopted, this was the only decision in which the Commission had applied the criterion of comparing the internal rate and the minimum rate in order to determine whether an investor in an airline met the criterion for a private investor. The Court further pointed out that, this being the case, the Commission was bound to respond, in the 1997 decision, to Alitalia's claim throughout the administrative procedure that its own situation was completely different from Iberia's situation as detailed in the Iberia decision and that, consequently, the high minimum rate applied in the Iberia case could not be applied in its own. The Court then looked in detail at some specific aspects of Alitalia's situation which the Commission had taken into consideration in the 1997 decision and which Alitalia had highlighted as illustrating the differences between its own situation and Iberia's. The Court found that 'the Commission did not explain (…) why it considered it necessary to apply to IRI's investment the same minimum rate of 30 % as it had adopted in the Iberia decision although the findings made in the contested decision give the impression, in particular, that a number of the risk factors which led the Commission, in the Iberia decision, to fix the minimum rate at that level, which was "very high and far higher than market rates", were not present, or were present to a lesser extent, in the Alitalia case (…)' (point 136 of the judgment).

([1]) OJ L 104, 27.4.1996, p. 25.

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(6) The risk factors to which the Court refers in the above extract relate to the following aspects:

— the failure to complete the adaptation programme properly and delays in carrying out staff reductions,

— social problems detrimental to the company's image and to making it difficult to achieve the envisaged productivity gains,

— the low level of productivity and the need to draw up a new cost-reduction plan in negotiation with the two sides of industry,

— doubts regarding the selection of future external partners,

— uncertainty regarding the effects of the liberalisation of air transport and ground handling activities on long-term profitability.

(7) Secondly, with regard to the manifest error of assessment noted in point 150 of the judgment, the Court quotes the section of the 1997 decision relating to the insolvency costs and notes, firstly, that 'it is not disputed that the main part of the capital injection of ITL 1 000 billion made in 1996 was used to repay to IRI loans amounting to approximately ITL 900 billion and that that operation can be regarded as a conversion of loans into capital' (point 145 of the judgment). The Court points out that the conversion of loans into capital is wholly consistent with one of the aims of the applicant's restructuring plan, namely to reduce the ratio of 'debt to equity'. The Court of First Instance then rejected the Commission's argument that the conversion into capital would bring only an immediate advantage, as well as the argument that the loans granted by Cofiri to Alitalia might constitute State aid. With regard to the second claim, the Court specifies that the 1997 decision puts forward no such reason and is not justified by any information provided by the Commission's consultants. The Court concludes that the Commission's reasoning concerning the insolvency costs is circular since, in order to determine whether a private investor would have made an investment of ITL 2 750 billion in the applicant's capital, the Commission started from the premiss that a private investor would not make the investment in question (point 149 of the judgment).

(8) Thirdly, with regard to the manifest error of assessment criticised in point 169 of the judgment, the Court opens by stating that 'the Commission did not reassess the minimum rate and the internal rate on the basis of the final version of the applicant's restructuring plan' (point 162) and so dismissed the Commission's argument relating to events occurring after the 1997 decision was adopted. The Court then notes that the method applied by the Commission to assess whether IRI's investment met the private investor test involves comparing the internal rate and the minimum rate of return on the investment and highlights the fact that the most recent amendments to the restructuring plan in June 1997 'are of such a kind as to cause the internal rate to rise (increased profitability) and the minimum rate to fall (reduced risks)' (point 167). The Court therefore finds that 'the Commission should have reassessed the minimum rate and the internal rate on the basis of the final version of the restructuring plan in order to be able to make an accurate assessment of whether IRI's investment satisfied the private investor test' (point 168 of the judgment).

(9) It should also be noted that the Court rejected Alitalia's claim based on the alleged miscalculation of the internal rate due to the fact that the Commission had obliged it to bear the costs of the early retirement programme for 700 of its employees. The Court records that the legal assessment and the operative part of the contested decision contain no trace of the applicant's decision to bear those costs, since the Commission only takes note of them in the part of the contested decision entitled 'The Facts'. The Court points out that as the commitment became irrevocable

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when Alitalia placed the relevant funds in escrow in July 1997, the Commission 'should therefore have ascertained whether the investment satisfied the private investor test in the light of that new situation' (point 154 of the judgment).

(10) In order to be in a position to respond fully to the requirements arising from the judgment of the Court, the Commission called upon independent consultants, Ernst & Young, who had previously assisted in the Alitalia case in 1996 and 1997 before the 1997 decision was adopted, and the quality of whose work was never challenged by the Court. Their main task was to supply the Commission with all the information it required in this instance to reapply the principle of the private investor in a market economy and, in particular, to calculate either the internal rate of return on the capital injection or the appropriate minimum rate taking account of the terms of the judgment of the Court of First Instance. The Commission's decision to appoint Ernst & Young to complete this work was natural, since it was the only agency capable of providing the necessary assistance in short order given its knowledge of the Alitalia case from 1996 and 1997 as well as the complexity of the necessary techniques and financial assessments. The consultants presented their report on 1 June 2001. It should be pointed out that the consultants appointed only provided the Commission with technical assistance and clearly cannot appropriate the Commission's own power of discretion to assess the character of the aid based on the de facto elements available to it.

LEGAL ASSESSMENT

(11) Pursuant to Article 233 of the Treaty, 'The institution or institutions whose act has been declared void or whose failure to act has been declared contrary to this Treaty shall be required to take the necessary measures to comply with the judgment of the Court of Justice.'

(12) This clause was clarified by the Court of Justice as follows: 'Where a measure adopted by an institution has been annulled by the court, the institution is required, in order to comply with the judgment and implement it fully, to have regard not only to the operative part of the judgment but also to the grounds which led to the judgment and constitute its essential basis, in so far as they are necessary in order to determine the exact meaning of what is stated in the operative part. It is those grounds which, on the one hand, identify the precise provision held to be illegal and, on the other, indicate the specific reasons which underlie the finding of illegality contained in the operative part and which the institution concerned must take into account when replacing the annulled measure' ([1]). The Court of Justice furthermore indicated that it was the responsibility of the institution issuing the measure which had been annulled to determine what measures were necessary in order to comply with a judgment on annulment ([2]).

(13) In the case in point, in order to take the Court of First Instance judgment into due consideration, the Commission is required to adopt a new decision revising the reasoning in the paragraph criticised by the Court as containing an error of reasoning and correcting the two manifest errors of assessment identified by the Court.

(14) As regards the procedure to be adopted in order to take this decision, Article 233 does not in this case require the Commission to reopen the procedure which led up to the 1997 decision or to

([1]) Judgment of the Court of Justice of 26 April 1988, *Astéris and others* v *Commission*, joined cases 97/86, 193/86, 99/86 and 215/86, ECR 1988, p. 2181, point 27 and summary, point 3.

([2]) Judgment of the Court of Justice of 5 March 1980, *Könecke* v *Commission*, Case 76/79, ECR 1980, p. 665, points 13, 14 and 15.

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repeat the entire procedure for adopting a new decision. In this respect, it is useful to draw a distinction between the error of reasoning, which is a formal error, and the two manifest errors of assessment, which are substantive errors. With regard to the error of reasoning, it appears from the established case law that when an act has been annulled because of formal or procedural flaws, the institution which issued the act may take up the procedure from the stage at which the flaw occurred ([1]). For example, on 22 July 1998, the Commission adopted the decision on the capital injection received by Air France, as notified, without reopening the procedure ([2]). As for the two manifest errors of assessment, the Commission considers that there are two reasons why it is not necessary to reopen the procedure: firstly, the new decision must be based on the factual evidence that existed at the time when the 1997 decision was adopted ([3]) and, secondly, the two errors identified by the Court of First Instance relate only to the assessment of facts which are themselves not in dispute. Moreover, the corrections which the Commission must make to the two paragraphs concerned are very clearly set out and specifically identified in the Court judgment. The Commission thus has sufficient access to the information it needs regarding the facts and the financial methods associated with these two points to satisfy the requirements of the Court of First Instance and does not consider it useful to invite Member States or interested third parties to submit their comments. It should also be noted that the Member States and the other interested parties have already had the opportunity to express their opinions under the administrative procedure leading up to the adoption of the 1997 decision and that their procedural rights have therefore been respected. The Commission thus has access to all the information it needs in order to adopt a new decision without the need to reopen the procedure laid down in Article 88(2) of the Treaty.

On the criterion of the private investor in a market economy

(15) The Commission points out that as part of the process of opening up the internal air transport sector market to competition, it published a notice concerning the application of ex Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector ([4]). The manner in which the Commission should apply the principle of the private investor in a market economy is clarified in detail in points 27 to 31 of these guidelines. This principle or criterion is a test which, when applied to a specific measure, is used to determine whether the beneficiary derives some advantage and may thus be considered as 'favoured' within the meaning of Article 87(1) of the EC Treaty. The test is based on the objective definition of State aid given in the Treaty and, unlike the assessment which the Commission has to make of the compatibility of aid under the terms of Article 87(3) of the Treaty, its application by the Commission is mandatory and non- discretionary. Indeed the Commission has systematically applied the principle of the investor in a market economy in examining the aid for restructuring granted to the following airlines: to Sabena in 1991 ([5]),

([1]) Judgment of the Court of Justice of 13 November 1990, Fedesca c.a., Case No C-331/88, ECR 1990 p. I-4023, and the judgment of the Court of First Instance of 17 October 1991, *De Compte* v *European Parliament*, Case T-26/89, ECR 1991 p. II-781 point 70.

([2]) OJ L 63, 12.3.1999, p. 66.

([3]) See the judgment of the Court of First Instance of 25 June 1998, *British Airways and others* v *Commission*, Joined Cases T-371/94 and T-394/94, ECR 1998 p. II-2405.

([4]) OJ C 350, 10.12.1994, p. 5.

([5]) Commission Decision of 24 July 1991. OJ L 300, 31.10.1991, p. 48.

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Iberia in 1992 ([1]), Aer Lingus in 1993 ([2]), TAP ([3]), Air France ([4]) and Olympic Airways ([5]) in 1994. In all those cases, however, the existence of State aid was not seriously challenged by the Member States concerned. When considering the capital injection received by Iberia in 1996, the Commission, in the process of applying the principle of the private investor in a market economy, employed a sophisticated method of financial analysis which in particular featured the minimum rate of return or 'hurdle rate' which an investor acting according to commercial principles would require of an investment. This was the analysis which the Commission applied to the capital injection of ITL 2 750 billion received by Alitalia as presented in the 1997 decision, which was subsequently annulled.

(16) The reasons for the annulment of the 1997 decision are attributable exclusively to the misapplication of the criterion of the private investor in a market economy: the remedy is therefore to reapply this criterion without committing the errors criticised by the Court of First Instance.

(17) It should first be noted that the Court rejected Alitalia's claim that private investor participation in the recapitalisation would in itself prove that the operation met the private investor criterion (point 92 of the judgment). Consequently, failing substantial participation by private investors in the operation, the Commission must employ a theoretical analysis. In this respect, the Court confirmed the validity of the method selected by the Commission, involving a comparison of the amount invested by IRI with the value of the anticipated future cash flows for the project, updating by means of the minimum rate (hurdle rate) required by a private investor (points 99 and 100 of the judgment). This method is tantamount to comparing the internal rate of return for the operation with the minimum rate which a private investor would require. Accordingly, the recalculation which the Commission is obliged to perform is limited to determining the internal rate of return for the operation and the minimum rate required by a private investor.

(18) The reassessment required in order to correct the manifest error of assessment which the Court of First Instance penalised by annulling the 1997 decision must take due consideration of the latest amendments made to Alitalia's restructuring plan in June 1997. Subject to pressure from the Italian authorities, calling upon the Commission to adopt a decision by the end of July 1997 (and acknowledging, moreover, the existence of elements of State aid), the Commission had not in fact considered it worthwhile recalculating the internal rate of return and the minimum rate to take account of the latest amendments to the restructuring plan before adopting the 1997 decision. It is true, moreover, that the later amendments were rather minor compared with those made to the plan in February 1997, which had been duly taken into consideration.

(19) Firstly, as regards the internal rate of return, it should be noted that the internal rate of return of a financial operation is the discount rate at which the amount invested is equal to the amount of the revenue generated by that investment. In the case in point, the future revenue to be taken into consideration is that forecast up to the end of 2000, the year in which the plan would be completed. Indeed, the company has valid financial projections up to this date, which is, on the one hand, far enough away in time to allow the capital increase in question to produce effects in the context of restructuring yet, on the other hand, near enough to offset the uncertainties inherent in the viability of the

([1]) Commission Decision of 22 July 1992. Not yet published.
([2]) Commission Decision of 21 December 1993. OJ L 54, 25.2.1994, p. 30.
([3]) Commission Decision of 6 July 1994. OJ L 279, 28.10.1994, p. 29.
([4]) Commission Decision of 27 July 1994. OJ L 254, 30.9.1994, p. 73.
([5]) Commission Decision of 7 October 1994. OJ L 273, 25.10.1994, p. 22.

▼B

financial forecasts. The revenue generated by Alitalia comprises, in the main, the added value acquired by the company until 2000 but also the dividends which Alitalia paid IRI until 2000.

(20) Furthermore, as the Court of First Instance stated in its judgment of 12 December 2000, the calculation of anticipated revenue should include the insolvency costs which IRI would have to bear if Alitalia were to go into liquidation, which would mainly be losses due to short term loans to Alitalia by Cofiri, an IRI subsidiary company, prior to June 1996. In this specific instance, such costs ought to be included given that the Commission had not shown that issuing such loans was in itself a form of State aid. As far as IRI is concerned, Alitalia's failure to pay back these short-term loans if the company were to be wound up, would be a cash flow loss. However, the total insolvency costs would not exceed ITL 1 000 billion, as the Italian authorities maintain in their letters to the Commission dated 29 July and 9 September 1996, and may be estimated at approximately ITL 750 billion. Indeed, the consultants' report of 18 June 1997 shows that the amount suggested by the Italian authorities overestimates the risk of losses on the short-term receivables, underestimates the sales value of the Alitalia fleet, overestimates the costs of liquidation and does not take account of the advance payments already made by Alitalia for the procurement of new equipment.
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(21) The added value acquired by Alitalia by 2000 compared with 1997, when the capital injection covered by this decision was actually made, is actually equal to the value of IRI's participation in the company in 2000 given that, in the opinion of the experts consulted both by the Commission and by Alitalia, in 1997 Alitalia's value was to be considered as zero. Some uncertainty remains, however, as to the percentage of IRI's participation in Alitalia capital until 2000 and also in that year since in 1997 it was not clear which tax provisions would apply to the transfer of Alitalia shares to its own employees when this operation was executed. The percentage of IRI's participation in Alitalia capital in the year 2000 therefore amounts to either 79 % or 86 % according to which of the two forms of taxation is applied. Obviously, the amount of IRI's participation in Alitalia capital and the value of the dividends collected vary according to which of these two percentage values applies. There is, however, no uncertainty regarding Alitalia's bearing the costs of early retirement payments as taken into consideration in the Commission's approach, since the Court of First Instance raised no objections (point 153 of the judgment). Alitalia's decision to bear the costs became irrevocable in July 1997 and therefore must be taken into consideration in the necessary calculation (points 154 and 156 of the judgment).

(22) In order to determine the value of Alitalia at the end of 2000 and hence the value of IRI's participation in the company at that time, the Commission used a method similar to that employed in the Iberia case ([1]). It involves multiplying Alitalia's estimated cash flow in a typical year following 2000 by a coefficient updating all future cash flows. Subtracting any debts outstanding in 2000 from the value of the asset calculated in this way gives the value of equity on that date. The multiplier coefficient applied to profit in a typical year is a function of both the average rate of cash flow growth for all the years following 2000 and the updating rate used for 2000. This value is no other than Alitalia's weighted average cost of capital on that date, which is equal to 9,53 %, the weighted average of the estimated cost of its debt (7,2 %) and the cost of equity (14 %) evaluated using the Capital Asset Pricing Model. It should be stressed at this juncture that the weighted average cost of capital defined in this way does not take Alitalia's specific risk situation into

([1]) Iberia Decision (see footnote 3), paragraph VII.

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account. The company's average rate of cash flow growth following 2000 may reasonably be set at 4,5 % at current prices. This value is calculated on the basis of the rate of long-term growth in the economy, the multiplier of this specific rate for the air transport sector and the predicted development of unit earnings and the rate of inflation. IRI's participation in Alitalia in December 2000 thus ►C1 comes to either ITL 4 179 billion or ITL 4 550 billion, ◄ depending on the tax provisions applied.

(23) Based on this data, the internal rate of return for IRI on its investment of ITL 2 750 billion in Alitalia capital is either 25,2 % or 26,1 % for 1997, according to the taxation applicable, as mentioned above.

(24) Secondly, with regard to calculating the minimum rate (hurdle rate) required by an investor operating according to commercial laws in order to undertake this kind of financial operation (capital injection) it should first be pointed out that a decision of this kind, for all that it takes hard facts into consideration, is not based purely on precise mathematical calculations but is also the product of assessment based on experience. Its empirical nature notwithstanding, the value of the hurdle rate can still be estimated to a fair degree of accuracy as is evidenced by the fact that financial institutions and investors taking an empirical approach generally all arrive at very similar conclusions for any given situation.

(25) In this case, on the basis of the information in its possession and, in particular, the consultants' report, the Commission considers the minimum rate to be around 30 % in view of the size of the sum involved and, more especially, the risks inherent in the operation. This rate of at least 30 % allows for the possibility that the restructuring plan will not develop as planned and that the actual return on the investment will, in the final analysis, be significantly less. Indeed, the rate cannot fail to be higher than the cost of equity capital since the latter does not take account of all the risks associated with the company, for, despite the improvements following adjustments to the restructuring plan in February and June 1997, as notified to the Commission on 26 June 1997, Alitalia must still be considered a company with a very high specific risk. In this respect, it should be noted that:

— traditionally, margins in the air transport sector are generally limited, with extreme variations in profits and losses,

— Alitalia's accounts have not shown significant profits since the end of the 1980s, despite the improvement in the economic situation from 1994 onwards. In fact, in 1996, the first year in which the restructuring plan was implemented, the company actually recorded losses of ITL 24 billion in contrast to the expected ITL 70 billion profits. It is true that in the letter to the Commission dated 15 April 1997 Alitalia supplied an estimate of its results for the first quarter of 1997 showing that the company's recovery was stronger than was anticipated in the restructuring plan, but it should be borne in mind, firstly, that these results are based on unrevised provisional data and, secondly, that six months is too short a time period to draw any significant conclusions,

— the company is in an extremely difficult and precarious financial situation. With its own resources at virtually zero at the beginning of 1996 and a high level of indebtedness, the company only avoided bankruptcy thanks to a capital injection of ITL 1 000 billion in June 1996. Considering the size of the company and the anticipated amount of the investment, this insecure financial situation is a factor which may in itself discourage any investor operating according to the principles of the market economy.

(26) There are other risk factors affecting the proper implementation of the plan, the long-term profitability of the company and the

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financial forecasts for 2000 which are the basis for calculation of the rate of return on the capital injection, to wit:

— the hypotheses regarding the future development of the company's productivity, operating expenditure, seat occupancy levels and unit earnings on which the plan is based are rather optimistic,

— the company's anticipated recovery is dependent to a great extent on the opening of the Malpensa airport after 1998. Yet, although the new Malpensa airport will offer far more slots than are currently available at Linate airport, which is already completely saturated, the slots will also be available to Alitalia's competitors. It should also be noted that the Malpensa airport facilities are located 55 kilometres away from the centre of Milan and that no other European airport infrastructure is located at a similar distance from the conurbation which it serves. The specific potential of the new airport and the details of how the hub will be put into service are in fact still largely unknown,

— the Italian domestic market, which is Alitalia's main market, was not liberalised until the end of 1999 and there is still major uncertainty as to how Alitalia, which previously enjoyed monopoly status, will be capable of handling competition. In this respect, it should be noted that the operating deficit recorded in 1996 is attributable to an appreciable drop in the company's unit earnings,

— Alitalia's unit costs continue to be higher than those of its main competitors in Europe, a situation attributable in the main to staffing costs which are too high compared with unit earnings which, by contrast, are somewhat lower than those of its European competitors,

— the company was affected by serious social disputes in 1995 and 1996, before the restructuring plan was adopted. There is uncertainty, too, regarding employees' attitudes to the additional measures to bring costs down and improve productivity which may be proposed in coming years. In general, the change in ‘business culture’ involved in the transition from a public institution with a monopoly to a company with no government backing operating in a market economy is likely to be hard to manage.

(27) The latest amendments made by the Italian authorities to the restructuring plan in June 1997, as notified to the Commission on 26 June, are not such as to invalidate the calculation of the hurdle rate. In addition to the Italian authorities' decision that Alitalia should bear employees' early retirement costs, the amendments include taking faster action to cut company expenditure by transferring Alitalia personnel to Alitalia Team more quickly than anticipated, reducing the total amount of the capital injection from ITL 2 800 to ITL 2 750 billion, and releasing Alitalia's shares in the Hungarian company, Malev, and in six regional Italian airports. While they undoubtedly reduce the inherent risks of the operation and increase the rate of return on the capital injection, these amendments are nonetheless not very significant and have far less impact than the earlier amendments by the Italian authorities to the restructuring plan in February 1997. Indeed, the June 1997 amendments have very little impact on the main results of the plan and on the expected share dividends. Financial forecasts updated to take account of these amendments show that their effects may be summed up as follows:

	1997	1998	1999	2000
Annual results	—	+ 8,9 %	+ 3,4 %	+ 2,5 %
Gross operating profit ([1])	+ 34,2 % ([2])	– 1 %	+ 1 %	+ 1,8 %
Net profit	+ 6,7 %	– 1 %	+ 1,4 %	+ 1,9 %

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	1997	1998	1999	2000
Dividends	+ 6,3 %	– 1 %	+ 1,2 %	+ 1,9 %

([1]) Result before tax and before extraordinary income and expenditure.
([2]) The deficit was reduced from ITL 38 billion to just ITL 25 billion, a 34,5 % improvement.

(28) In this respect, it is worth adding that in 2000 Alitalia's indebtedness, and the ratio of debt to equity (gearing ratio), is not significantly different. This, however, is precisely the data which an investor would see as crucially important when assessing the risks he would be incurring by financing the operation. The changes made to the restructuring plan in June 1997 thus have a virtually negligible impact on any assessment made by an investor guided purely by commercial criteria, considering that the inherent risks of the operation, as described above, continue to exist.

(29) The amendments to the restructuring plan made by the Italian authorities in June 1997 and, more especially, in February 1997, suggest instead, as the Commission concluded in paragraph VIII of the 1997 decision, that the restructuring plan now is such as to enable Alitalia within a reasonable time period to become viable in the economic context in which it has to operate, particularly in view of the fact that the restructuring plan, as amended, is based on more modest growth predictions than those first notified to the Commission on 29 July 1996. In this respect, it is worth pointing out that the issue of the firm's long-term financial and economic profitability is quite distinct from the type of profitability sought by an investor.

(30) The 30 % rate determined for Alitalia is identical to the rate established by the Commission in the Iberia case, which, as the Court of First Instance rightly pointed out, is bound to set a precedent. In this respect, the Commission considers that the risks inherent in the capital injection to Alitalia in July 1997 are at least as high as those involved in the capital injection received by Iberia in January 1996 for, while Alitalia and Iberia do not share exactly identical situations, both firms display very similar characteristics: they are comparable in scale, with a turnover of approximately EUR 4 billion in 1995, they operate in the same sector of the economy in a context of ongoing liberalisation within the Community, their internal market is not at the geographical centre of Europe and they have recorded systematic losses throughout the years prior to the capital injection. Furthermore, at the time of the capital injection, both Iberia and Alitalia are in dire financial straits characterised by high indebtedness and a virtually zero level of capital assets. The amounts of the capital injections in question are different, however, with Alitalia receiving EUR 1,42 billion and Iberia EUR 0,522 billion, a point which only adds to the inherent risks of the Alitalia recapitalisation plan from an investor's point of view.

(31) If the comparison between the Alitalia and Iberia restructuring plans notified to the Commission is pursued further, it becomes apparent that Iberia's productivity is less than Alitalia's and the Spanish company experiences uncertainties inherent in the effects of liberalisation of the ground handling market in Spain, a sector in which the company is prominent. However, ground handling operations account for only 13 % of Iberia's turnover, a proportion which is still less if the whole group is taken into account. Moreover, a hypothetical investor would see the risk factors involved in Iberia's situation as being more than outweighed by the twofold uncertainty of Alitalia's situation with regard to the conditions of the company's development at Malpensa Airport (a key part of the plan) and with regard to the effects of the liberalisation of Italy's internal civil aviation market. The Spanish internal civil aviation market was actually liberalised several years before the Italian internal market and,

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in 1996, it is already possible to see its impact on Iberia, whilst in 1997 the effects of the liberalisation of the Italian internal market on Alitalia are still very hard to identify. It should be added that Iberia has a privileged position in the market for routes between Europe and Latin America, whilst Alitalia has no such advantage. Another feature the two companies have in common, from an investor's point of view, is their social situation. The investor would no doubt observe that, in both cases, both sides of industry have made commitments to a certain extent to accepting improvements in productivity and reductions in production costs, but would consider more importantly the social disputes experienced by both airlines in the years leading up to the capital injection as well as the challenge facing both companies of transforming their business culture, adapting the characteristics of a public body that has enjoyed a long period of monopoly to the new market conditions. It should also be noted that, in both cases, doubts remain as to the existence and the arrangements for intervention in future by outside partners which still have to be selected.

(32) Finally, it is worth pointing out that in the air transport sector, historically, the very high rate of return of 30 % per year is justified in the experience of firms which have dealt with situations analogous to those which Alitalia faced in 1996 and 1997. For example, a number of the most important American airlines have had to face up to serious problems in the early 1990s before producing sizeable profits after 1995 and seeing their value increase considerably at the same time. The most spectacular example of this was the company Continental Airlines which between 1990 and 1993 took advantage of chapter 11 of the American law on bankruptcy and in which Air Partners and Air Canada invested USD 450 million in November 1992. Following the success of the firm's restructuring plans, particularly the 'Go Forward Plan', the company's share price increased fifteen-fold between December 1994 and May 1998, rewarding investors with an annual return of considerably more than 30 % over that period. In November 1998 Air Partners sold off the shares in Continental Airlines which it had purchased for USD 55 million at a price of USD 430 million, thus gaining, even without dividend payments, an annual return on the investment over a six-year period in excess of 40 %.

(33) In conclusion, the Commission decided that the annual minimum rate of return (hurdle rate) which an investor acting according to commercial principles would require in such circumstances in order to give Alitalia a capital injection of ITL 2 750 billion was higher than the internal rate of return for such an operation as already defined (recital 23). Indeed this conclusion is confirmed by the fact that no private investor agreed to take part in the operation.

(34) It should also be pointed out that the bulk of the capital input, or ITL 2 000 billion of the total ITL 2 750 billion, had to be made over as early as summer 1997, when implementation of the restructuring plan was scheduled to start. This factor increases the specific risks of the operation, since a private investor faced with a comparable situation would at an initial stage tend instead to input only the minimum capital necessary to keeping the company afloat and would pay the remainder only in due course when tangible evidence of a lasting recovery was forthcoming.

CONCLUSION

(35) The above considerations comply with the requirements of the Court of First Instance for clear reasoning and the three reasons that it gave for the annulment of the decision. Firstly, the manifest error of assessment consisting of the failure to include insolvency costs in the calculation has been remedied now that the insolvency costs are considered as positive cash flow (see recital 20). Secondly, the manifest error of assessment consisting of the failure to take account of the latest amendments to the

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plan in June 1997 in calculating the internal rate of return and assessing the minimum rate has been remedied, as those amendments have now been duly incorporated into the new calculation of the internal rate of return and the new assessment of the minimum rate which the Commission has carried out (see recitals 19 to 23 and 24 to 32, respectively). Thirdly, this decision complies with the requirement to present a clear statement of reasons on the point where the 1997 decision was deficient, namely determination of the minimum rate, since all the factors that led the Commission to set the value of the minimum rate at 30 %, as in the Iberia case, have now been explained in detail (recitals 24 to 32). In addition, the Commission's reasoning is presented in a clear and unambiguous manner so as to enable the European judge to exercise due judicial control and to enable interested parties to identify the reasons for the Commission's assessment for the purpose of defending their own rights.

(36) As to the remaining reasoning for this decision, particularly with regard to the compatibility of the aid, the Commission makes reference to the relevant paragraphs of the statement of reasons in the 1997 Decision, which should be deemed to form an integral part of this decision without the need to reproduce them in their entirety.

(37) The Commission further notes that the annulment of the 1997 decision eliminates the legal basis for the Commission Decision adopted on 3 June 1998 concerning the payment of the second instalment of restructuring aid to Alitalia. It is logical, therefore, not to object in this instance to the payment of the instalment in question. In this respect, the Commission makes reference to the reasons given in the letter sent to the Italian authorities on 16 June 1998 ([1]), which should also be deemed to form an integral part of this decision without the need to reproduce it in its entirety,

HAS ADOPTED THIS DECISION:

Article 1

The aid granted by Italy to the company Alitalia Linee Aeree Italiane SpA in the form of a capital injection of ITL 2 750 billion, payable in three instalments, intended to cover the restructuring of the company in accordance with the plan notified to the Commission on 29 July 1996 and adjusted on 26 June 1997, is compatible with the common market and the EEA Agreement pursuant to Article 87(3)(c) of the EC Treaty and Article 61(3)(c) of the EEA Agreement, subject to compliance with the obligations and conditions laid down in Articles 1, 2 and 3 of Decision 97/789/EC, as quoted in recital 1 of this Decision.

Article 2

The Commission has no objection to the payment of the second instalment of the capital injection to the company Alitalia Linee Aeree Italiane SpA.

Article 3

This Decision is addressed to the Italian Republic.

([1]) OJ C 290, 18.9.1998, p. 3.