II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 7 June 2005

on Alitalia's industrial restructuring plan

(notified under document number C(2005) 1651)

(Only the Italian version is authentic)

(Text with EEA relevance)

(2006/176/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having called on interested parties to submit their comments pursuant to the provisions cited above [1], and having regard to their comments,

Whereas:

I. PROCEDURE

(1) On 15 October 2004 Italy notified the Commission of Alitalia's industrial restructuring plan, in particular the planned recapitalisation of the company and the investment which the State holding company Fintecna SpA intended to make in its groundhandling services. Following the Commission's request of 21 October for additional information, Italy transmitted information to the Commission by letters of 21, 23 and 29 December 2004 and at meetings held on 27 October, 26 November and 14 December 2004.

(2) By letter of 20 January 2005 (SG (2005) D/200261), the Commission informed Italy of its decision to initiate the procedure provided for in Article 88(2) of the Treaty against these measures.

(3) The Commission initiated the procedure by decision of 19 January 2005 (hereinafter referred to as the 'decision to initiate the procedure'), which was published in the *Official Journal of the European Union* [2] on 19 February 2005. The Commission called on interested parties to submit their comments on the measures in question within one month of the date of publication, that is to say by 19 March 2005.

(4) The Commission received comments from interested parties on 17, 18 and 22 March 2005 [3], all of whom confirmed that their comments did not contain any confidential material. It transmitted these comments, including those received after the deadline, to Italy by letters of 18 and 30 March 2005, giving Italy the opportunity to respond to the comments within a period of one month. In order to ensure the greatest possible transparency of the procedure, the Commission decided to take account also of comments received from interested parties after the deadline and transmit them, on 30 March 2005, to the Italian authorities together with the comments received from interested parties within the deadline. The Commission received Italy's response to the comments from interested parties and to the decision to initiate the procedure by letters dated 18 and 20 April 2005.

[1] OJ C 44, 19.2.2005, p. 10.

[2] See footnote 1.

[3] The European Low Fares Airline Association (ELFAA) submitted its comments on 22 March 2005.

(5) Moreover, a meeting with the Italian authorities was held on 8 April 2005. This meeting was followed by the dispatch in the same letters of 18 and 20 April of additional information requested by the Commission. Further information, including that requested by the Commission on 20 April, was supplied by letters of 22 and 28 April, 31 May and 1 and 6 June 2005.

II. **BACKGROUND**

II.1. **The situation in July 2004 and the notification**

II.1.1. *Alitalia's financial position in recent years*

(6) Alitalia, 62,3 % of which is currently controlled by the Italian State, has seen its financial situation worsen considerably since 2003. Its balance sheet for 2003 showed further losses (before tax and financial and exceptional charges) totalling €379,5 million compared with a loss of €118,5 million in 2002. In 2004 its turnover dropped by 6 % compared with 2003, however with a strong impact of the way in which airport taxes were entered into the accounts. All in all, the net result for 2004 as a whole is expected to be a loss of €850 million. However, the result of the fourth quarter of 2004 (-€104 million before tax and exceptional charges) is better than that of 2003 (-€151 million). It was against this background that, by decision of 20 July 2004, the Commission approved rescue aid [4] (hereinafter referred to as the 'decision to approve rescue aid') of a maximum of €400 million consisting of a State guarantee of liquidity loans bearing 4,43 % interest per annum and repayable not later than twelve months after the last disbursement of funds. According to the report by Alitalia's directors on the state of the company's accounts at 30 June 2004, the loan was intended to cover the company's financial needs until March 2005.

(7) The Italian authorities have given several undertakings in the framework of the Commission's decision of 20 July 2004, in particular:

a) Alitalia assured the Commission that none of the routes opened from the 2004 summer season involved an increase in capacity as compared with the investments already agreed on 31 December 2002, and that all these routes were economic; it also confirmed that it did not currently practise predatory pricing on these new routes, nor would it do so in the future; the Italian authorities provided the Commission, in the framework of its analysis of the recapitalisation plan, with information showing that these undertakings were being honoured;

b) the Italian authorities also gave a written undertaking on 13 July 2004 that the State's share of Alitalia's stock would be a minority one within twelve months of the implementation of the rescue aid, that is to say before 8 October 2005.

II.1.2. *The restructuring measures notified*

(8) On 20 September 2004 Alitalia's board of directors adopted a new plan ('Industrial Plan 2005-2008') to address the company's serious economic difficulties. It includes a comprehensive set of measures intended to ensure the company's economic viability by increasing productivity and working hours and through cost control, better use of the fleet, etc. The new plan also provides for the separation of Alitalia's two activities, namely air transport (AZ Fly), which will retain the company's present legal form, and support, for which a subsidiary (AZ Servizi) will be set up to cover maintenance, groundhandling, information technology and shared services. The plan includes shedding 3 679 staff in Italy, using schemes provided for this purpose such as the 'Cassa Integrazione' which has been extended to cover the aviation industry in order to limit the social repercussions of such measures.

(9) Alitalia's restructuring involves two recapitalisations:

a) for AZ Fly with support from the State and from private investors contributing some €1,2 billion in early 2005 following approval of the accounts for 2004 at the shareholders' annual general meeting planned for 27 and 28 June 2005;

b) for AZ Servizi, which is to be assigned Alitalia's maintenance, groundhandling, information technology and shared services activities, involving approximately €220 million between 2005 and 2007 from the State-owned holding company Fintecna, before the proposed transfer of Alitalia's activities to private partners, possibly in separate sectors. Recapitalisation will take the form of subscription of ordinary shares and preference shares ensuring a preferred dividend.

[4] OJ C 125, 24.5.2005, p. 7.

II.1.2.1. The recapitalisation of AZ Fly

(10) As with the recapitalisation in 2002, the State's contribution should be on the same terms as that of the private sector. Italy has declared its willingness to give undertakings similar to those given on that earlier occasion. However, since this notification has been made in advance, the banks' letters of intent announcing their willingness to guarantee the successful conclusion of the operation in terms of the involvement of private investors were not yet available at the time of the notification. Other details of the operation, such as reducing the capital prior to recapitalisation to cover past losses, still have to be worked out. These could of course affect the share which the State could underwrite while still honouring its undertaking to privatise Alitalia.

II.1.2.2. The recapitalisation of AZ Servizi

(11) The two parties, Alitalia and Fintecna, have signed two letters of intent and have agreed, with the aid of their respective consultants, on a scheme which will yield a profit of approximately 25 % on the funds invested by Fintecna up to 2008; however, certain aspects of the operation still have to be negotiated between the parties.

II.2. **The Commission's initial assessment in the decision to initiate the procedure**

(12) From the information in its possession, the Commission could not rule out the possibility that these recapitalisations constitute State aid on the grounds that they do not comply with the principle of a private investor operating in a market economy. Since Alitalia already received restructuring aid authorised in 1997, confirmed in 2001 and paid between 1996 and 2001, it cannot, according to the 'one time, last time' principle, receive further aid.

(13) With regard to the €1,2 billion recapitalisation of AZ Fly, the Commission therefore wished to receive definitive guarantees that the private sector was also actually involved and that the undertaking to privatise the company which Italy had given in July 2004 was being honoured.

(14) With regard to the takeover of AZ Servizi by the State holding company Fintecna, the Commission wished to ascertain, with the aid of independent experts, that the operation would be profitable once the implementation details had been finalised, including as regards the future contractual relationship between the two companies and taking account of the existence of preference shares.

(15) The Commission therefore decided to initiate the formal investigation procedure in order to check, as soon as possible given the company's overstretched cashflow situation, whether the two recapitalisations proposed are compatible with the common market.

(16) The Commission also wished to give interested parties the opportunity to comment on any aspect of Alitalia's restructuring and recapitalisation plan which they believed should be brought to its attention. Should the recapitalisation measures covered by the present decision be considered state aid, all the Community rules on this subject would have to be applied in order to determine their compatibility. New restructuring aid would certainly infringe the 'one time, last time' principle as Alitalia already received state aid in the past and because the requisite ten-year period since the end of the last restructuring plan of 2000-01 has not yet elapsed. The Commission has also noted that a condition for the restructuring aid authorised in 1997 was that no further aid of this type could be paid to Alitalia. Finally, a similar undertaking was given by the Italian authorities for the present recapitalisation when the rescue aid was authorised in July 2004.

(17) In its decision to initiate the procedure, the Commission stated that, to the extent that the recapitalisation and the advantages granted to Alitalia were considered to constitute State aid within the meaning of Article 87(1) of the Treaty, it doubted that this aid could be compatible with the common market under the derogations provided for in Article 87(2) and (3) of the Treaty.

III. **COMMENTS FROM INTERESTED PARTIES**

III.1. **Preliminary remarks on the comments from interested parties**

(18) The Commission notes that the interested parties (a number of airlines and an association representing a number of airlines) criticise the planned financial support in part, namely the recapitalisation of AZ Fly and the takeover of AZ Servizi by Fintecna, in respect of which the investigation procedure was initiated by decision of 19 January 2005, but in particular the use by Alitalia of the rescue aid and especially the company's development with regard to the routes operated and its fares policy. In the account below, which covers the various comments submitted, the Commission has taken pains to distinguish these two aspects. The Commission recalls that in order to ensure the greatest possible transparency in its decision-making process and also in the event that an aspect of the recapitalisation were to be considered as aid and have to be evaluated as such, it has given interested parties the opportunity to submit their comments on the rescue aid, although the procedure initiated does not address this point.

III.2. **Comments submitted by the interested parties**

III.2.1. *Comments submitted jointly by eight European companies on 17 March 2005*

(19) The eight airlines (Austrian Airlines, British Airways, Finnair, Hapag Lloyd Flug, Iberia, Lufthansa, Scandinavian Airlines and TAP, hereinafter referred to as 'the eight companies') are of the opinion, as expressed in their joint letter of 17 March 2005, that the conditions for granting rescue aid have not been met, that Alitalia's restructuring plan entails new aid, and that the combination of these two facts produces significant spill-over effects.

III.2.1.1. Comments concerning the recapitalisations

(20) The eight companies take the view that the Commission focuses too much on the reduction of the State's share in Alitalia and that the compatibility of AZ Fly's recapitalisation, the takeover of AZ Servizi and the public support measures are also questionable. In their opinion, the private-investor principle does not seem to be complied with inasmuch as Alitalia is unable to guarantee a sufficient return on investment. In an annex, the eight companies note the following:

(a) the undertaking given in connection with the rescue aid (point 41 of the decision to approve rescue aid) to privatise Alitalia within twelve months has not been maintained. The separation of AZ Fly and AZ Servizi renders this principle applicable only to AZ Fly whereas the activity of AZ Servizi also benefited from the aid (point 58 of the decision to initiate the procedure). Accordingly, the plan submitted by Alitalia is inappropriate and an 'appropriate' plan should be submitted by 12 June 2005;

(b) the evaluation of profitability submitted by Fintecna (inappropriately called 'Finmeccanica' in the letter) is incorrect. The eight companies are of the opinion that the part of the capital of AZ Servizi held by AZ Fly must be taken into account in calculating the State share in AZ Fly's capital and that the calculation of the hurdle rate should be reviewed;

(c) the presence of conditions to which is subject Italy's obligation to privatise AZ Fly (point 28 of the decision to initiate the procedure) is not acceptable; in their opinion, the State's maximum share in the operation (€750 million) should immediately be reduced, in particular because no account can be taken of the possibility of 'unforeseeable and unfavourable market conditions'; they recall that in the Iberia case ([5]) the Commission had not accepted the request of the Spanish authorities to defer the company's privatisation because of problems in connection with the privatisation of its South American interests;

(d) the decision to initiate the procedure is silent regarding possible other elements of State aid such as the extension of the social support scheme for workers made redundant (points 18 and 19); since it appears that these elements have not been notified they constitute unlawful aid that must be recovered. The eight companies recall that in the Iberia case cited above the Spanish company had to bear all its restructuring costs from its own resources; the same procedure should be applied to Alitalia and the costs of reducing its staff should be set out in a new restructuring plan;

(e) the eight companies further point out that certain facts have not been presented in sufficient detail; for instance, in point 48 of the decision to initiate the procedure it is not clear whether the two A319 acquisition options mentioned therein were decided on 30 May 2000; it is not permissible to exercise these options on the basis of the aid granted to rescue the company.

III.2.1.2. Comments on commercial development and the rescue aid

(21) The eight companies consider that the crucial point is Alitalia's use of techniques to increase its capacity and open new routes, found to be running at a loss because of Alitalia's aggressive pricing policy.

(22) They take the view that the new routes could be opened to eastern Europe thanks to the theoretical closure of existing routes which are in actual fact operated by partners such as Air France and Alitalia Express and on which Alitalia can sell seats unrestrictedly and cash in on the proceeds thanks to unrestricted code-sharing agreements.

(23) The eight companies argue that the opening of new routes to Skopje, Zagreb, Timisoara, Budapest, Sarajevo and Saint Petersburg in November 2004 makes no economic sense; most of these are strongly linked with 'ethnic' traffic flows during the summer months and Alitalia has pursued the fares policy of opening these routes well beyond this phase to fill seats on its own aircraft, which has caused these routes to be loss-making.

(24) The eight companies conclude that the continuous aid provided to AZ Fly maintains an unsatisfactory status quo which has the effect of delaying any decision to consolidate and definitively reduce activity and in the meantime passes the company's difficulties on to its more efficient competitors. They therefore ask that the Commission adopt the measures necessary to remedy the situation.

([5]) Commission Decision 96/278/EC of 31 January 1996 concerning the recapitalisation of the Iberia company (OJ L 104, 27.4.1996, p. 25).

(25) In Annex 2 to their letter of 17 March 2005, the eight companies provide a comparison of the development of Alitalia's services between the first week of June 2004 and June 2005:

(a) in domestic traffic, 20 destinations were served in both cases; the frequencies increased by 17 % and the seats on offer by 20 %;

(b) in intra-European traffic, 10 new destinations were added (Birmingham, Manchester, Lyon, Krakow, Skopje, Zagreb, Timisoara, Budapest, Sarajevo and Saint Petersburg); the frequencies increased by 17 % and the seats on offer by 10 %;

(c) in traffic outside Europe, two new destinations were added (Delhi and Shanghai) but Accra was discontinued; the frequencies increased by 22 % and the seats on offer by 15 %.

(26) The eight companies annexed tables to the letter in support of their arguments on the following points:

(a) compensation of AZ's reduced capacity between Rome, Milan and Paris by its partner Air France and between Milan and London by its subsidiary Alitalia Express;

(b) strong rise in frequencies to Central and Eastern Europe (99 a week in June 2004; 207 planned in June 2005);

(c) allegation of Alitalia's price leadership on destinations in Central and Eastern Europe;

(d) allegation of acquisition of market shares by Alitalia between October and December 2004 on destinations in Central and Eastern Europe that are stagnating or in decline;

(e) allegation of acquisition of market shares by Alitalia on destinations in Central and Eastern Europe in the period from September 2004 to January 2005 compared with the same period in 2003-2004;

(f) allegations concerning the loss-making operation of the Milan-Malpensa– Saint Petersburg route.

(27) Finally, in Annex 1 to their letter, the eight companies contest the need for rescue aid on the following grounds:

(a) the aid, which among other things is intended to cover the negative cash flow (points 15 and 39 if the decision to initiate the procedure), is in actual fact used to pay salaries and make up for the increase in the price of fuel (point 23 of the decision);

(b) the aid was not used from 1 October 2004, but nor was it used before 15 December 2004. The eight companies conclude that the aid was not necessary in the fourth quarter of 2004 but in the first quarter of 2005 by double the amount provided for; according to them, the aid has thus become unlawful and should be re-examined in light of the new 2004 rescue and restructuring guidelines, under which a refund must be paid within not more than six (rather than twelve) months, that is to say before 15 June 2005 in this case;

(c) according to the eight companies, the restructuring plan notified within six months is in any case not appropriate because, having given rise to the initiation of a procedure, it is not to be ruled out that it comprises State aid elements.

III.2.2. *Additional letter from British Airways (BA) of 18 March 2005*

III.2.2.1. Comments on recapitalisation

(28) In its letter sent to the Commission on 18 March 2005, BA draws attention to the aid previously received by Alitalia and authorised by the Commission; it argues that in the current situation the planned recapitalisations do not comply with the principle of a private investor operating in a market economy and that they constitute new, incompatible aid. BA regrets that the data provided in the decision to initiate the procedure are insufficient and asks to be given more time to submit its comments on any new documents. In this regard, the company mentions the conditions for the loans granted to Alitalia and the transfer of debts to AZ Servizi.

III.2.2.2. Comments on commercial development and the rescue aid

(29) BA confirms its comments formulated jointly with the seven other airlines and takes the view that Alitalia has used the rescue aid to develop its activities beyond the permitted market share. BA feels particularly affected by the Italy-Delhi route, for which the Italian market is small and which mostly concerns the British market.

(30) BA also raises three different aspects:

(a) the first point concerns transport rights from Milan which for technical reasons, according to BA, puts foreign airlines at a disadvantage as they are obliged to operate from Malpensa whereas Alitalia can continue to operate from Linate. BA further alleges that, similarly, AZ Express enjoys preferential treatment with a fourth daily flight from Linate to London whereas its competitors can operate only three;

(b) moreover, BA claims that Alitalia benefits from a dominant share of a €40 million reduction in navigation charges linked with domestic flights;

(c) finally, BA argues that in 2004 the Italian authorities tried to prevent it from becoming the price leader on long-haul flights from Italy via London and that this attempt was averted only because the British authorities approached their counterparts over the matter.

III.2.3. *Additional letter from Austrian Airlines of 17 March 2005*

(31) In a letter with additional information sent to the Commission on 17 March 2005, Austrian Airlines (OS) reiterates many of the arguments already adduced together with the seven other airlines and those put forward by BA. With regard to Alitalia's conduct on the market and the rescue aid, OS emphasises however that Alitalia's conduct has had a particular impact on its market position as OS operates in a market which is geographically nearby and which is already greatly affected by other forms of competition, which it considers 'normal' because they do not involve State aid, but which are nevertheless clearly felt, such as the presence of low-cost airlines and airlines based in Central Europe such as Czech Airlines.

(32) OS enclosed with its letter copies of internal e-mails with the intention of showing that Alitalia operates from a position of price leader in a given market and on a certain date; OS also enclosed a number of tables for flights from Brussels comparing Alitalia and OS on some twenty routes during the period from March to May 2005.

III.2.4. *Comments from ELFAA of 22 March 2005*

(33) ELFAA (European Low Fares Airline Association), which in March 2005 comprised ten airlines (Norwegian, Transavia, Hapag-Lloyd Express, Air Berlin, Flybe, Sterling, Sky Europe, Wizzair, Sverige flyg and Ryanair), submitted its comments to the Commission by letter faxed on 22 March 2005.

(34) As regards procedure, ELFAA wishes to have access to the dossier as an interested party and asks to be consulted before any final decision is taken. It regrets that the Commission had not postponed initiating the procedure until it had received final information from Italy and notes that this fact, combined with the absence of the words 'serious doubts' from the decision to initiate the procedure, indicates that the Commission did not genuinely wish to apply the rules on State aid in this case.

III.2.4.1. Comments on recapitalisation

(35) With regard to the substance of the decision to initiate the procedure, ELFAA strongly opposes the measures planned by Italy. It cites the transfer of €1,6 billion debts from Alitalia Fly to AZ Servizi, the State's support amounting to €300 million for the social plan and the planned recapitalisation of AZ Fly by the Italian State amounting to €750 million.

III.2.4.2. Comments on commercial development and the rescue aid

(36) ELFAA alleges that Alitalia has violated the conditions laid down for rescue aid by announcing its intention to expand its fleet, acquire a competing company and opening new routes. ELFAA also mentions the airport structures of which AZ has exclusive use without the costs pertaining thereto being fully included in the costs invoiced to the company, for which it invokes public service obligations without justification under Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community aid carriers to intra-Community air routes ([6]); in this connection, ELFAA cites the recent case of 18 routes between Sardinia and the mainland ([7]).

IV. **COMMENTS SUBMITTED BY ITALY**

(37) Like the comments received from interested parties, Italy's comments also distinguish between those relating to the aspects for which the investigation procedure was initiated (in other words the planned recapitalisation of AZ Fly and Fintecna's shareholding in AZ Servizi) on the one hand, and, on the other, the comments relating to the verification of the rescue aid authorised in 2004, for which the Commission had invited observations from interested parties and from Italy, that is to say the expansion of services and Alitalia's conduct on the market as well as the way in which the funds guaranteed by the rescue aid are used. Finally, some of Italy's comments relate to other points raised by the interested parties that are not covered by either of these two aspects.

(38) Italy states that the comments submitted by ELFAA, dated 21 March 2005, are inadmissible because they were submitted after the deadline of one month after publication of the decision to initiate the procedure. Italy has nevertheless also responded to these comments.

([6]) OJ L 240, 24.8.1992, p. 8. Regulation as last amended by Regulation (EC) No 1882/2003 (OJ L 284, 31.10.2003, p. 1).
([7]) OJ L 75, 22.3.2005, p. 53.

(39) The Italian authorities have also sent the Commission a note stressing the need for a swift and positive decision by the Commission. They point out that the general meeting of Alitalia's shareholders which has to approve the accounts for 2004 is planned for 27 and 28 June 2005, that is to say on the deadline of 180 days required by law following the closure of the financial year. They also point out that the meeting of the board of directors that has to approve the draft balance sheet is set for 20 May 2005 ([8]). In the absence of a Commission authorisation of the recapitalisation, or at least an indication in this regard, Alitalia does not rule out the possibility that, in view of the accumulated losses, the balance sheet may have to be drawn up with a view to the possible liquidation rather than continuity of the company.

IV.1. **Comments submitted in connection with the decision to initiate the procedure**

IV.1.1. *Comments on the recapitalisation of AZ Fly*

(40) On this point, Italy notes that Alitalia has approached several foreign and Italian banks to obtain a declaration of intent to guarantee the successful execution of the planned recapitalisation, in the spirit of the letters of intent obtained at the time of the recapitalisation of 2002 in compliance with the Commission's requests. Italy states that it has obtained an undertaking to this effect from Deutsche Bank which also covers the current share held by the Italian State in respect of which it cannot subscribe to the recapitalisation if it is to meet the commitment of reducing its final share to below 50 % of Alitalia's capital. According to Italy, the wider scope of this commitment compared with 2002 demonstrates the actual feasibility of the privatisation. It argues that the contents of this letter remove all doubts as to the amount and exact conditions of the State's participation in the recapitalisation.

(41) The Commission has received a copy of the letter of intent dated 19 April 2004 sent by Deutsche Bank to Alitalia whereby Deutsche Bank accepts to conclude a contract to underwrite or have underwritten the success of the recapitalisation operation for a maximum amount of €1,2 billion, up to a maximum risk of €650 million and in any event for an amount enabling the reduction of the Italian State's share in the company's stock to 49,9 %. Deutsche Bank and AZ Fly have agreed that the price or the price range for the issue of the new shares will be determined jointly and will represent a reduction of at least […] (*) % of the quoted market price after taking account of subscription rights.

(42) Italy has provided the Commission with an analysis carried out by Deutsche Bank specifying the circumstances of AZ Fly's recapitalisation in comparison with similar operations carried out on various European markets since 2003:

(a) the bank explains first of all that the background to the recapitalisation is the past unfavourable results for the company whose management is currently focusing on reducing costs while also still facing a difficult competitive situation involving pressure from its competitors on the domestic market, and the sharp rise in fuel prices in recent months, which are factors that may adversely affect the company's accounts. The success of the industrial restructuring plan will therefore be particularly important to persuade the investors to subscribe to the capital increase, especially in view of a substantial reduction in the share of the current majority holding;

(b) the current structure of Alitalia's capital, consisting of small private shareholders and not involving investment funds specialised in air transport, combined with the cyclical and volatile nature of the sector, therefore makes it necessary to involve specialised investors in the operation specifically oriented towards the added value generated. Attracting this demand means offering shares at a sufficiently attractive subscription price;

(c) analysis of some thirty recapitalisations effected on most European stock markets since April 2003, with details provided, amounting on average to €1 240 million, or 43,2 % of their previous capitalisation, shows that the difference between the subscription price and the theoretical ex right price (or TERP) ([9]) has on average been 22,8 % and 28,1 % for restructuring companies ([10]);

(d) in the case of Alitalia, the planned capital increase represents 127 % of current capitalisation (approximately €943 million); it thus represents more than 1 500 days of exchange of securities on the stock market in the recent period. The price difference in similar cases with regard to this latter criterion, for example for Heidelberg Cement, exceeded 38 %.

([8]) The date for the meeting of the management board has been postponed to 26 May 2005.

(*) The part of the text in brackets refer to business secrets or confidential information that have been left out.

([9]) TERP (theoretical ex right price) is a weighted average between the reference quoted market price and the subscription price of the new shares. Every shareholder receives a pre-emptive right whose theoretical value is the difference between the reference quoted market price and the TERP which assures the asset balance of the operation for the old shareholders.

([10]) Swiss Life Holding, Ahold, ABB, Royal & Sun Alliance, Heidelberg Cement, Allianz.

(43) Italy points out that the […]% difference indicated above applies to all the new shares issued and that it has not received any other request from Deutsche Bank for specific conditions for the subscription of the shares to be underwritten by it; nor does an agreement of this type exist between Deutsche Bank and the Ministry of the Economy.

(44) The guarantee and management fees have been fixed at […]% of the value underwritten by Deutsche Bank or the consortium; to this must be added a […]% commitment fee. Also on this point, Italy has transmitted an analysis carried out by Deutsche Bank showing that this total fee [amounting to 5 %] (**) of the guaranteed value is in conformity with normal practice for similar operations effected since the end of 2002:

(a) the bank reiterates the observations already made with regard to the sector, the tightness of Alitalia's securities market and the need to maximise demand through measures which are an incentive for banks to subscribe to the capital;

(b) on the basis of some thirty recapitalisation operations effected since November 2002 on most European stock markets, which are detailed in the information supplied and which largely coincide with the first list referred to, the average fee was 3,44 %. For operations ([11]) comparable to that of Alitalia in terms of the size of the market capitalisation and the number of days of stock market trading, the average was 4,96 %;

(c) for instance, in the case of the €800 million capital increase of Fastweb SpA in February 2005, with a better risk profile, the fee was 5,38 %; in the case of Rhodia, a company comparable to Alitalia in terms of number of days on the stock exchange, impact on the capitalisation and difference with the TERP, it was 5,60 %.

(45) In order to fully guarantee that their subscription will in fact be on private-sector conditions, the Italian authorities sent the following formal undertaking to the Commission on 22 April 2005:

'The Italian authorities undertake to effect the subscription of their part of the planned increase in Alitalia's capital on the same market conditions as those that will be offered to private investors, in particular with regard to the issue price and the rights connected with the new shares issued, and at a level bringing its own share in the company's capital to 49,9 % at the end of the operation. Moreover, the Italian authorities, having taken cognisance of the letter sent by Deutsche Bank to Alitalia on 19 April 2005 and forwarded to the Representation, undertake to intervene in the capital increase operation only once the suspensive conditions of the commitment made by Deutsche Bank in the aforementioned letter have been met and the banks responsible for the subscription have given a formal commitment without reservations — except with regard to the usual conditions connected with force majeure, acts of war, terrorism and similar — to guarantee the "successful outcome" of the recapitalisation operation. The Italian authorities also undertake to transmit to the Commission, immediately upon their conclusion and prior to the subscription by the Ministry of the Economy and Finance of the new capital increase, the final contracts concluded with the banks containing the above-mentioned formal and unconditional subscription commitments. The Italian authorities will also transmit a report explaining the levels of actual subscription to the aforementioned capital increase once the operation has been completed.' ([12])

(46) Moreover, Italy disputes the view that the privatisation ([13]) of AZ Fly alone is contrary to the undertakings contained in the decision to approve rescue aid. In this regard, Italy refers to the text of the decision to initiate the procedure ([14]) and to the private management approach to the AZ Servizi operation; this applies both to Fintecna's acquisition of the holding in AZ Servizi and to the final objective of the transfer of the relevant activities to third parties.

(47) With regard to the impact which unforeseeable and unfavourable market conditions may have on the operation, Italy contests the reference which the interested parties have made to the Iberia case; in that case, the Commission had to exclude any possibility of new aid as the company was not in that position. Italy argues that the Commission has always considered the undertaking to privatise as subject to market conditions that are not unfavourable and unforeseeable ([15]).

(**) The exact data have been left out and replaced by this indication.

([11]) Fastweb, Rhodia, Hagemeyer, SGL Carbon, Scor.

([12]) Letter sent to the Commission via Italy's Permanent Representation to the EU.

([13]) The Commission points out that this concerns a reduction of the part of Alitalia's capital held by the State to below 50 % and that the term 'privatisation' used by the Italian authorities does not prejudge a possible classification of the undertaking in accordance with Article 2 of Commission Directive 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings (OJ L 195, 29.7.1980, p. 35).

([14]) Points 28 and 59.

([15]) See Commission Decision 94/662/EC of 27 July 1994 on the increase of Air France's capital (OJ L 258, 6.10.1994, p. 26).

(48) On 22 April 2004 Italy also transmitted to the Commission the update to Alitalia's industrial plan adopted by its board of directors on 14 April 2004. The revised plan is based on the same approach as the initial plan and still distinguishes two stages, the improvement stage in 2005 and 2006 and the relaunching stage in 2007-2008. While the second stage involves increasing the company's services through the introduction of new aircraft, the initial stage is aimed at guaranteeing continuity of operation, maximising existing capacity and restoring productivity. The revised plan notes that there has been a 30 % rise in the price of fuel compared with the previous plan, that is to say an annual cost increase of €75 million, and sets out more cautious expectations on standard revenue from short- and medium-haul flights because of the arrival of competing low-cost airlines on the domestic market. However, the revised plan maintains the envisaged level of profitability through more assertive cost control which should lead to additional annual savings of approximately €160 million in 2006 through better know-how within the company thanks to its new management and the sound development of initiatives already taken. Consequently, the break-even point will be reached by the end of 2006 and operating costs measured in CATK (unit cost per available tonne kilometre) would diminish, as envisaged in October 2004, by approximately […]% over the period covered by the plan with a slightly more favourable 2004 base; the margin, calculated as EBITDAR ([16]), would rise from […] % in 2005 to 14 % in 2008 (in the initial plan the envisaged values were […] and 14 % respectively).

IV.1.2. *Comments on the recapitalisation of AZ Servizi by Fintecna*

(49) In this regard, Italy recalls that the Commission decided to seek the assistance of Ernst & Young Italia to ascertain whether such operations are compatible; it submits no additional comments but confirms that negotiations between Alitalia and Fintecna are still in progress. The transfer of groundhandling activities from Alitalia to AZ Servizi, which is preliminary to the recapitalisation, had been planned for the end of April 2005 and has now been implemented ([17]).

(50) With regard to the use of preference shares, Italy notes that this is widely practised in Europe and it gives the example of the articles of association of Volkswagen AG and Unilever; it also points to the importance of this type of capital in companies such as Hugo Boss, Henkel and Porsche, where it accounts for 40 to 50 % of the shares and, although to a lesser extent, in certain other companies such as Abertis, BMW, MAN and RWE.

(51) In the opinion of the Italian authorities, AZ Fly's shares in AZ Servizi should not be included in the calculation of the hurdle rate; the company does not take part in the increase in AZ Servizi's capital but, on the contrary, will be gradually reducing its share.

(52) In response to the allegation that Alitalia will transfer debts to AZ Servizi, the Italian authorities recall that these financial liabilities, amounting to €1,7 billion, consist of convertible bonds or debts secured on the fleet; they should therefore fully remain with AZ Fly.

(53) Italy has also specified the arrangements made between Fintecna and Alitalia on the future distribution of the return on the investment in AZ Servizi as provided for in the letter of intent of 13 October 2004 signed between the parties ([18]). They have agreed that Alitalia's present and future participation in the negotiations on the possible transfer of AZ Servizi's activities and its willingness to facilitate these, including through contractual arrangements, to the extent that they do not entail a worsening of its contractual position with regard to services or prices, should be offset by compensation going beyond a purely mathematical share in AZ Servizi's profits. Accordingly, Fintecna and Alitalia have agreed that the share in the profits obtained by Fintecna exceeding 25 % of the internal rate of return (IRR) ([19]) as provided for in the industrial plan will be paid back to Alitalia at the rate of […]% of the amount above this sum. This evaluation will be carried out either on the basis of the transfer, where completed or, on 31 December 2008, on the basis of the flows obtained by Fintecna and the evaluation of the economic capital of AZ Servizi held by Fintecna. This evaluation will be carried out according to the same method as that adopted in the current industrial plan submitted to the Commission and on the basis of a report by an independent expert.

(54) With regard to the future contractual relations between AZ Fly and AZ Servizi, Italy specifies that the fares charged for the various services will remain within a market range, even if negotiations lead to fares that are higher than those initially proposed by Alitalia. This has led to a reduction of the discount for maintenance services from […] to […]% to AZ Fly's benefit as the maximum discount is normally obtained on the market by a company which entrusts maintenance of its fleet to a single service provider for a period of seven years. Similarly, the […]% bonus negotiated with Fintecna for invoicing groundhandling services keeps the tariffs within the market range.

([16]) Earning Before Interest Taxes Depreciation Amortization and Rentals.

([17]) The transfer was announced on 29 April 2005 on Alitalia's website which also provides details of the net balance sheet regarding the transfer; the transfer takes effect on 1 May 2005.

([18]) Last indent of point 35 of the decision to initiate the procedure.

([19]) Internal rate of return (IRR).

(55) On 1 June 2005, following the meeting of Alitalia's board of directors of 26 May 2005, Italy also transmitted to the Commission the final contract signed between Alitalia and Fintecna which is intended to govern the way in which Fintecna takes up its participation in AZ Servizi.

(56) Italy has specified that the other provision negotiated between the parties, in other words the return to AZ Fly of a part of the profit up to a maximum value of […]% of the amount invoiced, that is to say €[…] million over four years in the plan notified ([20]), corresponds exactly to the compensation for these values; the current business plans of AZ Fly and AZ Servizi are consistent with regard to the prices of services invoiced/paid and to future potential fares (for AZ Servizi) and returns (for AZ Fly).

(57) Following the updating of the 2005-2008 industrial plan approved on 14 April 2005, Italy assured the Commission that the plan had no material impact on AZ Servizi and therefore did not affect the valorisation of the company and the yield on the investment planned by Fintecna. Relying on documents drawn up by Mediobanca, Italy stated that the final value remains that envisaged, the initial value of AZ Servizi will be €94 million, rather than the expected €97 million, Fintecna's contribution will be €216 million rather than the expected €221 million, and its internal rate of return (IRR) will remain at 25,3 %.

(58) As regards the status and nature of the independent Fintecna company, Italy has confirmed, in addition to the information provided in point 33 of the decision to initiate the procedure, that Fintecna does not benefit from any derogation: its board of directors, while appointed by the shareholder — that is to say the State – , is answerable for its management choices to the company and third parties; in the framework of the law on bankruptcy, the company has the same status as companies under private law; there is no longer any general or specific statutory guarantee by the Italian State for Fintecna, and the company has met all the publication requirements obviating the single shareholder's liability provided for in Article 2362 of the Italian Civil Code.

(59) At the Commission's request, Italy also explained the nature of the link between Fintecna and the former IRI S.p.A. After IRI was wound up on 27 June 2000, the State reorganised and transferred its holdings. 53 % of the Alitalia shares held by IRI was transferred to the Treasury by decree of 21 December 2000 at a provisional value of ITL 1 797 128 641 402, approximately €654,5 million. This value should be corrected upon the transfer, even in part, of the securities held or after evaluation by two consultants if the Treasury so requires. The transfer was not accompanied by a payment but by the grant by IRI to the Treasury of an interest-free credit in the same amount.

(60) At the recapitalisation of Alitalia, authorised by the Commission on 19 June 2002, a part was reserved for the Treasury to incorporate into the capital the last two tranches of the restructuring aid received. Because the other shareholders were excluded from the right of option, the established value per share (€0,96) was certified, in accordance with Article 2441 of the Civil Code, by Deloitte and Touche, the auditors of Alitalia. This value was also used to establish the final value of the transfer of 2000 from IRI to the Treasury as provided for by the decree of 27 June 2002 at an amount of approximately €788 million. The decree also provided that the interest-free loan credit would become due at the latest on the date on which IRI's accounts for 2002 were approved.

(61) Finally, a decree of 2 April 2003 established that Fintecna had taken over IRI on 1 December 2002 and had revised the conditions for the settlement of the loan/credit as it had become less urgent to do so; the date of settlement, and therefore the reimbursement by the Treasury, was thus postponed to the time of transfer of the Treasury's holding or at the latest before the approval of Fintecna's 2004 accounts, that is to say not later than 30 June 2005.

IV.2. **Comments on verification of the rescue aid**

(62) The Italian authorities point out, as set out in detail in points 63 to 84, that the comments submitted by the interested parties often appear to be based on an approximate assessment of inaccurate information and focused on an alleged increase in the capacity offered and predatory prices on the routes operated. According to the Italian authorities, moreover, the comments made by the interested parties include unfounded 'aggressive' allegations, for example the alleged existence of double aid in 1997 and 2002 and the assertion that new aircraft had been acquired, which in actual fact had already been decided in 2002.

(63) Moreover, Italy considers these criticisms are self-contradictory because the parties on the one hand accuse the Italian company of using the rescue aid to enhance its capacity and on the other hand consider the aid as unnecessary because of its belated take-up.

([20]) In the revised plan, this value is €[…]; see point 109.

IV.2.1. *Comments on the services offered and on Alitalia's conduct on the market*

IV.2.1.1. Comments on the services offered and on capacity

(64) Italy points out first of all that Alitalia had from 2000 pursued a policy of downsizing with a steady diminution of services on offer; consequently, the TKO (tonne kilometre offered) decreased from 5,7 billion in 2000 to 5,1 billion in 2001 and to 4,2 billion in 2002 with a concomitant reduction in the average daily use of aircraft (7 hours 41 minutes for a medium-haul aircraft in winter 2003-2004 compared with a market average of 8 hours 30 minutes). This had enabled Alitalia's competitors to conquer substantial market shares on certain expanding markets such as China, Eastern Europe and India. A recovery occurred only from 2003 (4,4 billion TKO) but especially from 2004 (4,8 billion TKO); it is expected that the TKO will reach 5,5 billion in 2005. This development has been in progress since winter 2004-2005 and should lead to a strong increase in the daily rate of use of aircraft in line with best practice in the sector.

(65) To justify the increase of services on offer between summer 2004 and summer 2005 (Alitalia's competitors had indicated the first week of June of the two years as a model week), Italy has provided the following table for reference purposes:

TKO trend summer 2005 v summer 2004

x 1 000 tonnes

	SUM04	SUM05	Delta	**Delta** %
Domestic	521 651	608 157	86 506	16,6 %
International	981 821	1 148 124	166 303	16,9 %
Intercontinental	1 385 817	1 562 744	176 928	12,8 %
	2 889 289	3 319 025	429 737	14,9 %

This trend is due to the following:

(a) daily flight times changed between the two periods from […] to […], with an average daily increase of […] minutes ([21]);

(b) on the basis of TKO in summer 2004 and the number of hours of flight ([…]), the figure is […] TKO/mn;

(c) the […] additional daily minutes per aircraft for the 214 days of the season lead to […] TKO, that is to say for 184 aircraft on 31 March 2005 […] million TKO.

(66) Italy points out that if the fleet as it stood at 31 March 2004 (186 aircraft) had been maintained, the capacity increase would have been even higher (+[…]% instead of 14,9 %). However, there has been increased use of services combined with a decreasing fleet, as on 31 December 2005 the fleet had been reduced to […] aircraft as a result of the phase-out of the MD 80-82 aircraft. This fleet and the capacity it offers correspond to that of the entire Alitalia group, including Alitalia Express.

(67) Italy has also confirmed that the acquisition of the two Airbus A 319, which had been planned as an option, had been decided before 31 December 2002.

(68) However, there has been a strong increase in the rate of use made of the fleet following the redesigning of the network of routes to optimise the deployment of resources, aircraft and crews, and following the reorganisation of maintenance procedures, with most of the activity taking place during the night. Accordingly, with 186 aircraft on 31 March 2004, Alitalia had a […]% rate of use, equal to […] aircraft; with 184 aircraft on 31 March 2005, it attains a rate of […]%, equal to […] aircraft.

(69) Italy concludes that it is perfectly possible for the company to significantly improve its services on offer while remaining within the boundaries of the capacity commitments given when the rescue aid was approved. The additional services offered were focused on the markets with the strongest growth from and to Italy for which there were no direct connections, a situation from which Alitalia's competitors benefited: Eastern Europe, China and India. According to Alitalia, these markets have shown a growth rate to and from Italy respectively of 6,3 and 7,3 % in 2004 and 2005 for Eastern Europe, 10,5 and 11,2 % for China, and 5,9 and 7,2 % for India. With regard to Eastern Europe, Italy draws attention to the fact that the growth of Alitalia on these markets has had the effect of stimulating traffic demand, with the increase in daily bookings exceeding the additional services on offer from the company.

(70) In respect of the special case of Delhi, cited by BA, Italy denies the alleged substitution effect. Delhi represented one of the main passenger flows from Italy without direct connection (87 passengers a day in each direction and major freight volumes); the market shows a strong growth and has counter-seasonal characteristics with peaks in winter, which is interesting from the point of view of use of capacity.

([21]) From […] to […] for short- and medium-haul aircraft; from […] to […] for long-haul aircraft.

(71) With regard to the abandonment of particular flight frequencies between Rome and Paris, Italy explained that this was connected with Air France's request for a rebalancing operation in the context of the joint venture agreement between the two companies; under the joint venture, the share of frequencies operated by Air France on this route rose from […]% in summer 2004 to […]% in summer 2005.

IV.2.1.2. Comments on the profitability of routes

(72) Italy has indicated that the opening-up of new routes is intended to enhance the company's profitability; to this end, these routes, which make use of capacities that have become available through the increased rate of use of aircraft, should present a positive gross margin, that is, marginal revenue exceeding marginal costs, even though because of the decreasing marginal profitability formula their average profitability is below that of the rest of the network. The data supplied by Italy for the end of September and the latest forecast for 2005 all show a positive result.

(73) However, at the Commission's request, following the analysis carried out by its consultants Ernst & Young, which indicated negative gross margins on the new routes to Scandinavia at the end of December 2004, Italy has provided additional information. It notes first of all that at the end of the year, and in particular in October, revenue per available tonne-km (RATK) had been particularly low, with a drop of 14,2 % compared with October 2003 as a result of the concern caused by Alitalia's precarious financial situation. Moreover, the difference in advance bookings diminished progressively in September-October 2004 compared with the same period in 2003, becoming negative at the beginning of October for bookings for December.

(74) Italy further indicates that, according to the standards used in the sector, the effective profitability of a route should be evaluated after three IATA seasons in order to eliminate the effects connected with the opening of the route and seasonal trends.

(75) Finally, Italy indicates that, for a network carrier such as Alitalia, profitability should be evaluated by including also the additional margin generated by connecting flights resulting from the new routes, or 'feeder value'; the data supplied show positive feeder values for all the routes, including the three Scandinavian routes which have a negative direct margin ([22]).

([22]) N.B.: For Fiumicino-Stockholm, Italy provides a feeder value of €[…] million above that indicated by Ernst & Young, making the route a positive one; this difference is justified (see the expert's conclusions) by the strong increase in connecting flights traffic during the winter season of 2004-05.

IV.2.1.3. Comments on pricing policy

(76) In response to the competitors' criticism of Alitalia's price leadership policy, the Italian authorities explain that the company has based its business strategy on matching the reference competitor's prices to prevent the competitors from benefiting from having a competitive pricing advantage vis-à-vis the most price-sensitive customers. Deviations from the price matching policy are due either to the launching of new routes or to promotional campaigns limited to a couple of weeks.

(77) Italy explains that these practices are perfectly normal on the international aviation market and that all of Alitalia's competitors systematically adopt this strategy for the same reasons ([23]). In light of the decision to grant rescue aid, Alitalia had restricted its recourse to promotional practices compared with market practices.

(78) Of 175 routes, whether direct or indirect, new or otherwise, and for a particular period, indicated by the eight companies and OS in their comments, according to the information provided by Alitalia there were 159 (91 %) on which Alitalia's fare is higher than (18 % of cases), equal to (in most cases, namely 69 %) or less than €6 lower than its competitor's fare (2 % of cases). In 16 cases, that is to say 9 % of all routes, Alitalia's fare is less than the competitor's fare: 11 cases (6 %) concern promotions on new destinations, of which two from Saint Petersburg and eight to or from Zagreb; conversely, five cases (3 %) concern promotions on routes existing before summer 2004. By mid April 2005, when the Italian authorities submitted their reply, they pointed out that such promotions as price leader had ended.

(79) Finally, with regard to the alleged flights operated with a negative gross margin on the Malpensa-Saint Petersburg route, Italy explains that:

(a) the average revenue per passenger for Alitalia is more than €[…] per segment, and not €150 per return flight as claimed by the eight companies;

(b) between January and March 2005, Alitalia carried on average not 30, as claimed, but […] passengers per flight;

([23]) Italy cites the example of Austrian Airlines (OS) which opened its Vienna-Varna route in winter 2004 with a promotional fare of €299 in Austria, without an indication of the period of validity, as against €399 for its competitor Bulgarian; the date of validity was fixed only on 29 March 2005. Moreover, OS launched its Vienna-Turin route on 9 April 2005 at a fare of €249 compared with Alitalia's €299.

(c) Alitalia's variable costs are €[…] per flight and per passenger, in other words lower than the figures claimed;

(d) the estimated gross margin for 2005 (€[…] million or […]% of revenue, excluding feeder value) is clearly positive.

IV.2.2. *Comments on the use of the credit guaranteed through the rescue aid*

(80) Italy notes that the aid was fully implemented in the period envisaged by the decision to approve rescue aid, that is to say before 31 March 2005. Italy has therefore indicated that the full repayment should theoretically be due on 31 March 2006, that is to say 12 months after the take-up of the last instalment of the loan. However, the Italian authorities have agreed to ensure that the rescue aid is refunded within eight working days following the recapitalisation of AZ Fly and in any event before 31 December 2005.

(81) The Italian authorities take the view that the expenditure criticised above (fuel, remunerations, etc.) form part of the operational costs necessary to keep the company going and are therefore strictly disbursements in accordance with the 1999 guidelines.

(82) With regard to the use of the loan over time, the Italian authorities point out that the decision to approve rescue aid does not lay down any provision requiring that the aid should be used in specific periods and that the way in which its use is managed in the period covered by the Commission's authorisation does not entail any additional advantage for the beneficiary company and does not constitute a new measure. Consequently, the point in time when the loan is used is compatible with the Commission's decision to approve rescue aid.

(83) Italy puts forward two further arguments in support of the legality of its recourse to rescue aid and the level thereof. The first argument concerns the average level of cash assets which an airline should have; in the past, this level was equal to approximately six weeks of the turnover, though the current trend is towards 10-12 weeks due to the events of 11 September 2001. The accounts at the end of 2003 of the major airlines show that they have held an average of 17 % of their turnover in cash and equivalents, with variations from 9 to 28 %; in Alitalia's case, it claims, 17 % is tantamount to approximately €700 million. The €500 million cash assets actually held by Alitalia can therefore still be considered a reasonable level.

(84) Secondly, Italy also refers to the strong shocks to which the aviation sector has been exposed, which have further accentuated the above-mentioned trend, in particular for the weakest airlines. As a result, Alitalia's suppliers have adopted an extremely 'cautious' attitude towards it. In this connection, Italy has transmitted letters from a number of its suppliers which confirm this trend. For instance, attention may be drawn to the following:

(a) in June 2004, the leasing company GECAS agreed to deliver the B777 as planned only on condition of maintaining a guarantee bond of USD […] million initially due to Alitalia; similarly, the lease-back of four ERJ-170 aircraft was possible only on condition of raising from six to nine months the deposit paid for each aircraft;

(b) between March and September 2004, several fuel suppliers (Q8, Total and Shell) required the payment of deposits and/or pre-payments for a total sum of approximately €[…] million;

(c) a number of 'acquirers', that is institutions managing credit card transactions, especially in North America, have asked for an increase in the reserves set aside by Alitalia under the contracts in force to cover the customer risk in the event of insolvency. For instance, in April 2004 First Data asked for an increase of Alitalia's deposits from USD […] to […]million. Overall, the amounts held by these firms vis-à-vis Alitalia now total approximately USD 25 million worldwide.

Finally, Italy mentions the legal proceedings instituted before the Court of Milan by the airport management company SEA which has led to the seizure of €28 million from 16 current bank accounts, which has effectively blocked Alitalia's cash position until the assets are released.

IV.3. **Other comments**

(85) With regard to the comments from the interested parties that concern neither the recapitalisations nor the verification of the rescue aid, in particular BA's comments on the situation in Milan, Italy considers that these are unconnected with the procedure and are therefore inadmissible. Nevertheless, it points out that the fact, complained of by BA, that it is not possible to operate a fourth daily flight at Milan-Linate is simply due to the fact that there are no more slots available. Alitalia Express itself has had to use another slot for that destination, a slot which Italy regards as lawfully transferred under Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports ([24]). On the other hand, Italy recalls that Alitalia has for more than ten years been fruitlessly seeking to obtain a new slot to London-Heathrow.

([24]) OJ L 14, 22.1.1993 p. 1. Regulation as last amended by Regulation (EC) No 793/2004 of the European Parliament and of the Council (OJ L 138, 30.4.2004, p. 50).

(86) Similarly, Italy denies that it has practised sixth-freedom fares control, unlike other Member States, such as Germany and the United Kingdom. In fact, the reason why ENAC took fare control measures in summer 2004 on the basis of the bilateral agreements in force was to put an end to a discriminatory situation in which the Italian companies could not apply fares lower than those practised by the German and British airlines on their markets whereas the latter could do so on the Italian market. Following the Commission's intervention, the Italian authorities suspended this practice on a reciprocal basis with the other Member States.

(87) With regard to the comments submitted by ELFAA, Italy denies the existence of any advantage in the form of direct financial compensation to Alitalia. It notes that the company uses the airports in full conformity with national and Community rules. As for the comments regarding public services, Italy has since January 2004 operated the Rome-Cagliari route without any financial compensation from the State even though such compensation was initially provided for in the call for tenders. The company complained to the Commission about the new imposition of 18 public service obligations on routes between the Italian mainland and Sardinia, and the matter is currently being investigated by the Commission. Finally, Alitalia has benefited from public service compensation, as provided for in the call for tenders and in Regulation (EEC) No 2408/92 ([25]), only for the Rome- and Milan-Crotone routes; both of these routes have however been given up by Alitalia and will cease operating on 30 April 2005.

(88) With regard to the financing of redundancies, Italy maintains that the extension of the social schemes to the aviation sector is a general measure of economic and social policy which makes use of instruments already used in other sectors such as the metal and mechanical industry. The Italian authorities have explained that the recourse to the Cassa Integrazione for the aviation sector is in compliance with the procedures used in the past for other sectors of the economy and did not benefit from any particular advantages. The extension of the application of the Cassa Integrazione to industrial workers, on the basis of a law of 5 November 1968, or to the cleaning sector, on the basis of a decree law of 19 July 1994, followed similar procedures and had immediate effect, or a retrospective effect in the latter case. In the aviation sector, other Italian airlines (Meridiana, Volare and Azzurra Air) and foreign airlines (Swiss and British Airways) have lodged or are about to lodge requests for compensation for their personnel.

([25]) See footnote 6.

(89) Moreover, Italy has asked for the rectification of a number of what it considers to be inaccuracies and material errors contained in the text of the decision to initiate the procedure ([26]).

V. RESULTS OF THE INDEPENDENT EXPERT'S OPINION REQUESTED BY THE COMMISSION

(90) As already announced in its decision to initiate the procedure, the Commission decided to appoint an expert to examine a number of matters raised therein. The purpose of initiating the procedure was to obtain an independent assessment of the AZ Servizi recapitalisation plan and, in particular, of the profitability expected by Fintecna from taking part in the operation ([27]). Also, following the comments already made by the interested parties before the initiation of the procedure and in line with its duty to monitor authorised aid, the Commission had announced its intention to verify, possibly with the assistance of an expert, that Italy was honouring the business commitments it had made on routes and prices at the time of the decision to approve rescue aid and that the loan guaranteed by this aid was being used in accordance with the rescue aid decision ([28]).

(91) On 4 February 2005 the Commission entrusted the task of carrying out these checks to Ernst & Young Italia, the expert consultants it had already used in a number of cases involving restructuring aid given to Alitalia and who were therefore well acquainted with the dossier. The Commission did not avail itself of the option open to it under the decision to initiate the procedure ([29]) whereby it could, if it saw fit, make use of an expert appointed jointly with the Italian authorities. Ernst & Young Italia (hereinafter referred to as 'the expert') performed its tasks under the sole supervision of the Commission. The expert submitted its final report to the Commission on 13 April 2005; the main findings are set out in points 93 to 148 below. It should be borne in mind that the report does not constitute a certification of Alitalia's or AZ Servizi's accounts or forecasts, in the sense of a full audit, but represents what is generally called a 'fairness opinion' on the information which follows provided by Alitalia, Fintecna and their respective consultants, Mediobanca and Citigroup.

(92) On 20 April 2005, following the adoption on 14 April 2005 of the plan as revised by Alitalia, including the part concerning AZ Servizi, the Commission asked the expert to verify whether its earlier findings remained valid in the light of the revised plan. The expert's report thereon was submitted on 22 April 2005.

([26]) Italy's comments have been included as far as necessary in the present text.
([27]) Point 61 of the decision to initiate the procedure.
([28]) Points 49 and 65 of the decision to initiate the procedure.
([29]) Point 72 of the decision to initiate the procedure.

V.1. **Findings regarding the notified AZ Servizi operation**

(93) These findings relate to that part of the decision to initiate the procedure which concerns the planned take-over of AZ Servizi by Fintecna, the expected profitability of this operation for Fintecna and the nature of future business relations between AZ Fly and AZ Servizi. The Commission would state that the other part of the initiating decision (the recapitalisation of AZ Fly) was not covered by the expert study. It should be mentioned that unless otherwise specified all the figures quoted below have been taken from the revised version of 14 April 2005 of AZ Servizi's industrial restructuring plan for 2005-2008 and from the analyses carried out by Mediobanca and Citigroup for this purpose, which were reviewed in the expert's report of 22 April 2005. Additional information was supplied on 25 May 2005.

V.1.1. *Comments regarding the discrepancies between the initial plan of October 2004 and the revised plan of 2005*

(94) The expert detailed the main points of difference between the initial plan as presented in October and its April 2005 update. The main purpose of the revised plan is to realign the 2005 figures with the budget presented after the initial plan, so the activity forecast for 2005 has been revised, the €/$ exchange rate has been adapted to the present situation, and the rate of implementation of the economic measures has been readjusted in line with what has been achieved. AZ Servizi's scope of operations has been slightly changed, for example removing groundhandling at Cairo airport, which cannot for legal reasons be transferred to a third party that is not an air carrier. Although there are quite substantial differences between the two plans from one activity to another or costs may be offset against and revenue, ultimately the general effect is slight, except for 2005 when, with slightly higher activity and lower costs, the effect is of a reduction in losses, as EBIT ([30]), from €[…] to €[…] million. In 2008, the year used for the evaluation, EBIT are up by €[…] million, from €[…] to €[…] million. However, if EBIT and EBITDA ([31]) are rising, which should push up the final figure, their distribution by activity and increasing investments, which has an impact on cash flow available to shareholders, can have the opposite effect.

V.1.2. *Findings regarding the calculation of profitability for Fintecna*

(95) In this connection, the expert checked the methodology used by Mediobanca, Alitalia's financial adviser, when calculating the IRR ([32]) of 25,3 % expected by Fintecna when it invested in AZ Servizi. The expert found these methods to be in line with established theory and professional practice. The expert also analysed the work done by Citigroup, the adviser chosen by Fintecna, and carried out its own sensitivity analyses, concluding that 'we have not found any indication that the methodology used when determining an IRR of 25,3 % for Fintecna's investment in AZ Servizi is not correct.'

(96) The expert re-examined in greater detail the new investment flows envisaged by Fintecna, totalling €216 million, described in point 37 of the decision to initiate the procedure, and their breakdown into preference and ordinary shares, as well as the calculation carried out by Mediobanca and described in point 38 of the decision.

(97) Fintecna's investments will now be made as follows:

a) in 2005, a total contribution of €130 million comprising: €98 million by subscription to ordinary shares with which Fintecna will acquire 51 % of the share capital of AZ Servizi and €32 million in preference shares ([33]). Fintecna will therefore hold 58 % of the total share capital and Alitalia 42 %;

b) in 2006, a capital increase of €64 million by way of preference shares;

c) in 2007, a final contribution of €22 million by subscription to preference shares with which Fintecna will ultimately have acquired 69,7 % of AZ Servizi's share capital and will continue to hold 51 % of the ordinary capital.

Ultimately, Fintecna's contribution will be €216 million and AZ Servizi's total share capital €310 million.

(98) The estimated return from the operation as calculated by Mediobanca is based on year 2008 flows: forecast free cash flow, less any foreseeable maintenance investments, exceptional operations (especially restructuring costs),

([30]) Earnings before interests and taxes.
([31]) Earnings before interests, taxes, depreciation and amortisation.
([32]) See footnote 19.

([33]) Preference shares, provided for under Article 2348 of the Italian Civil Code, are a type of share which accords only limited voting rights in extraordinary general meetings and in meetings to decide on the distribution of annual dividends but gives the holder priority over holders of ordinary shares as regards reimbursement in the event of winding up, and as regards the distribution of dividends.

and fiscal adjustments — that is the residual cash flow available to the shareholder — is estimated at around €35,6 million. After updating, the final value ([34]) is calculated as €442,7 million. How this amount is shared between the two shareholders, Fintecna and AZ Fly, is largely determined by the capital structure:

a) in 2008 the preference shares, held only by Fintecna, will represent 38 % of the total share capital, but benefit from a preferred dividend equal to 5 % of the total share capital, or €15,5 million in 2008. It was made clear that the possibility of a preferred dividend had existed from the outset but can only be achieved from 2008 since there has not been a sufficient net result beforehand. The updated value of this dividend is €151,8 million;

b) the remainder of the final value, or €442,7 — €151,8 = €290,9 million, will be shared out in accordance with the total stock held by the two shareholders, that is to say 69,7 % (€202,7 million) for Fintecna, and the balance of 30,3 % (€88,2 million) will go to AZ Fly;

c) the final value estimated for Fintecna is therefore €151,8 + €202,7 = €354,5 million; in relation to its investment of €216 million (€130 million in 2005, €64 million in 2006 and €22 million in 2007) and considering the amount of cash liquidity available (€29 million) at the end of the period, the IRR for Fintecna is 25,3 %.

(99) The expert confirmed that the calculation method used, that is perpetual capitalisation of normalised flows, is one of the methods adopted for the matter in hand. It also stated that the rate of cost of equity (Ke) taken into consideration, that is to say 10,2 %, is based on a no-risk rate taken from 4,25 % government bonds, a market premium of 4,50 %, a risk index (beta levered) of 0,88 derived from comparable quoted firms ([35]) and, finally, a premium of 2 % indicating the risk attached to the fact that AZ Servizi is not a quoted company.

(100) The expert then checked the calculations made by Citigroup for the same purpose. It concluded that they rely on the same basic data but use one of the other standard methods for assessing the final value based not on the perpetual cash flow growth of the company as a whole but on the application of market multiples calculated on the basis of the EBITDA in respect of each of AZ Servizi's activities (maintenance, groundhandling, shared services and information technology); these multiples are drawn from comparable firms operating in the same markets, at times with a 30 % reduction in view of the monopsony enjoyed by the relevant AZ activities. Citigroup took account of four successful-outcome scenarios based on the AZ Servizi plan, ranging from full achievement of objectives as regards savings made and new turnover from third parties to only 60 % achievement of savings objectives and 85 % achievement of turnover objectives.

(101) On the basis of the first scenario considered by Mediobanca, the IRR for Fintecna according to the market multiples applied is between 29 % and 38,3 %, that is higher than that of Mediobanca ([36]). On the basis of unofficial scenarios and therefore subject to further caveats, the average of the four scenarios would give an IRR of 18,7 % to 27,1 %, a range which includes the value calculated by Mediobanca. Only the most unfavourable scenario would result in an appreciably lower IRR of between 9,1 % and 17,1 %, which would in any event be equivalent to or higher than the cost of capital. The expert notes that in its calculations Citigroup failed to take account of the final cash liquidity of €29 million available to Fintecna, which ought to be included according to generally accepted practice and which would improve these figures. The expert concludes that the Citigroup study confirms Mediobanca's results.

(102) Apart from validating the studies carried out by Mediobanca and Citigroup, the expert made its own analyses, in particular, first, a study of the sensitivity of the IRR in relation to the final value of AZ Servizi and in relation to the cost of capital and the inflation rate, and, second, a fresh calculation of the final value of AZ Servizi.

(103) So far as concerns the capital increase by Fintecna of €216 million provided for in the revised plan, giving a final value (non-available) in Fintecna's favour of €354,5 million with an IRR of 25,3 %, the expert concluded that a final value of less than 10 % (€320 million), attributable for example to results below 10 % ascribable to Fintecna ([37]), would give an IRR of 20,7 %. A final value 20 % lower than the plan (€284 million) would give an IRR of 15,8 %, while a final value 20 % higher than the plan (€426 million) would produce an IRR of 33,8 %.

([34]) The final value was calculated on the basis of the estimated financial flow for 2008 for the company in question; the value was updated applying a constant growth rate of 2 % p.a. — in line with the expected medium-term inflation rate — which is regarded as consistent with the possibilities of improvement of efficiency by Fintecna and of a cost of equity of 10,2 % p.a., judged to be in line with the market average.

([35]) These are firms operating in the maintenance field, like BBA Group plc, Goodrich Corp, Singapore Technologies Engineering, Hong Kong Aircraft Engineering; in groundhandling services, such as Fraport AG; and in information technology and shared services, such as Electronic Data Systems Corp, Computer Sciences Corp, Cap Gemini SA, Indras Sistemas SA, Atos Origin, TietoEnator OYJ.

([36]) It should be noted that the final values, almost always higher than those calculated by Mediobanca, are not directly comparable because the model used by Citigroup includes growing increases in capital: thus, if the same IRR is to be obtained, the final value has to be higher.

([37]) In relation to the estimated annual flow of €35,6 million, a standardised flow of €32,6 million in 2008, for example, would generate a final value for Fintecna of €329 million.

(104) Various risk scenarios, generating a different beta risk index and a different cost of capital (Ke), were postulated; these scenarios are summarised in the following table, which shows the final value resulting for Fintecna (excluding €29 million available cash), the internal rate of return (IRR) and the net present value (NPV) of the flows updated to the same cost of capital of each scenario. It is to be borne in mind that the NPV updates the various disbursement flows, corresponding to the capital increases underwritten by Fintecna, and revenue flows, corresponding in this case to the estimated final value and to the portion available at the end of the period; a positive NPV indicates value created for the investor.

Scenario	Beta levered	Liquidity risk premium	Cost of capital Ke	Final value for Fintecna	IRR	NPV
Base	0,88	2 %	10,20 %	354,5 M€	25,3 %	+81 M€
Equity beta	1	2 %	10,75 %	333 M€	22 %	+52 M€
Ke + 2 %	1,32	2 %	12,20 %	287 M€	16,20 %	+19 M€
Equilibrium NPV	1,56	2 %	13,27 %	260 M€	13,27 %	0 M€
Ke - 2 %	0,88	0 %	8,20 %	465 M€	38,10 %	+182 M€

The base scenario is that taken into consideration by Alitalia, Fintecna and their consultants.

The 'equity beta' scenario takes account of the fact that AZ Servizi's low forecast indebtedness leads mathematically to an undervaluation of the beta coefficient; an equity beta of 1 corresponds to the beta coefficient of firms operating in the same market, without applying the reduction linked to AZ Servizi's indebtedness; this generates about half a percentage point increase in the cost of capital.

The 'Ke + 2 %' scenario corresponds to a beta coefficient fixed at 1,32, that is the average of the highest equity beta coefficients of the sample considered, in every case disregarding the reduction associated with AZ Servizi's low level of indebtedness; this generates an increase in the cost of capital by 2 percentage points.

The 'equilibrium NPV' scenario sets the NPV at zero, in other words the threshold of profitability of the operation; it corresponds to a cost of capital of 13,27 %, that is a beta of 1,56.

In contrast, the 'Ke — 2 %' scenario corresponds to a 2 percentage point reduction in the cost of capital, due to the disappearance of the liquidity risk premium or a significant drop in the beta coefficient, or a combination of the two.

(105) Finally, the expert carried out a full re-evaluation of AZ Servizi using a method similar to that applied by Citigroup whereby the value of the firm is regarded as the sum of the values of all its activities. These values were calculated on the basis of a market multiple of the EBITDA for groundhandling and staff and call centre, and of the EBITDA less investments for information technology; the same 30 % reductions were taken into consideration for the latter two activities. The expert explained that this method of market multiples becomes more reliable as the financial markets evolve and that both academic writers and international practice attach growing importance to it. As regards maintenance, the particular structure of the activity, with the majority of services continuing to be provided by branches of airline companies and with contracts under negotiation being of limited duration, led the expert to adopt an assets-based approach, based on assets for 2008, also described by the expert as one of the methods generally used for company valuations ([38]). Accordingly, and taking into account the financial position in 2008, the global final value for Fintecna would be between €408 and €430 million, that is giving an IRR of around 28,2 % to 30,9 %, thus confirming Mediobanca's and Citigroup's calculations.

(106) The expert concluded that the favourable discrepancy in terms of IRR compared with the same calculations carried out for the first plan of October 2004 is primarily due to the deferral of part of Fintecna's investment to 2006 instead of 2005.

V.1.3. *Findings regarding the assumptions made in the letters of intent signed by Alitalia and Fintecna*

(107) In its decision to initiate the procedure the Commission claimed ([39]) that three points, which according to the letter of intent signed on 13 October 2004 between Alitalia and Fintecna still remained to be negotiated, could have a significant influence on the profitability of the operation. The Commission therefore asked for them to be specifically examined by the expert.

([38]) NB: The Commission notes that the expert's valuation of the activity of maintenance on the basis of fixed assets for 2008 entails its being considered equal to 3,8 times the EBITDA for 2008; this value is lower than the multiples applied by Citigroup for that activity (from 4,5 to 5,5).

([39]) Points 35 and 59 of the decision to initiate the procedure.

V.1.3.1. Treatment of restructuring costs

(108) The expert confirmed that the letter of intent provides that the restructuring costs calculated by Alitalia would continue to be borne by Alitalia if they were to exceed the provision created and transferred to AZ Servizi. That provision amounted to €88,8 million in the initial plan and according to the detailed checks made, tallied fully with the estimated share of those costs that have to be covered in addition to the staff costs already considered in the annual liabilities for 2005. In the revised plan for April 2005, this provision was reduced to €75 million at the end of 2004 due to the costs of around €15 million already entered in the accounts for 2004. The expert confirmed that Alitalia's undertaking means that there is unlikely to be any impact on Fintecna's IRR.

V.1.3.2. Treatment of the objectives of the restructuring plan

(109) The expert was able to confirm that the costs included in AZ Servizi's plan used for calculating the IRR were in line with the efficiency objectives laid down therein; the plan provides for a maximum annual percentage of […]% of the invoiced amounts to be repaid to AZ Fly if the objectives are attained; this corresponds to about €[…] million per year or, in the period 2005-2008, €[…] million in the revised plan. The expert stated that, according to Alitalia's management, such an estimate can be considered to be confirmed by the various players involved in drawing up the plan, including the consultants, who included it in their calculations.

V.1.3.3. Treatment of the capital gains from the transfer of assets or areas of activity

(110) The expert confirmed that the treatment of any such capital gains, still subject to negotiation at the time of the expert's study, would have no impact on profitability for Fintecna if their partial retrocession to AZ Fly took place only after all transfers planned up to 31 December 2008, and if it concerned only that part of the IRR greater than the 25,3 % calculated by Mediobanca as Fintecna's estimated profitability. The parties confirmed to the consultant that that was the approach they wished to adopt for negotiating the clause.

V.1.4. *Findings regarding use of the preference shares for Fintecna's benefit*

(111) The expert first pointed out the many different types of shares existing under Italian law; in particular, since the company law reform of 1 January 2004, the right to priority payment of a dividend, as in the present case, no longer imposes any particular restrictions as regards associated voting rights. The only restriction which does apply lies in the fact that shares with a limited or conditional voting right, as in the case of preference shares, cannot account for more than half of the share capital ([40]).

(112) The expert put forward three examples of private quoted companies (Fiat SpA, Unipol Assicurazioni SpA and Istituto Finanziario Industriale SpA) which issue preference shares according, amongst other things, a priority in the distribution of profits that is associated with a fixed amount per share or corresponds to a percentage of the nominal value.

(113) The expert confirmed that it had found nothing to indicate that the granting of preference shares to a single shareholder, whether public or private, was contrary to Italian law. The only advantage observed is precisely the priority interest-bearing access to the profit dividend.

V.1.5. *Findings regarding advance billing for services provided by AZ Servizi to AZ Fly at market conditions*

(114) The expert dedicated a large part of its report to a presentation of the detailed work carried out on this, describing the billing practices applied in AZ Servizi's plan; the plan had been drawn up by Alitalia with the assistance of McKinsey, which supplied it with the analysis elements direct. The work focused on each of the firm's activities (maintenance, groundhandling services, information technology and shared services (staff and call centre)) and its findings are set out below. The expert concluded generally that it had found no indications that the methodology used for setting prices reflecting market conditions in AZ Servizi's plan might be flawed.

(115) It should be noted that Fintecna consultant Citigroup's report says that AZ Servizi's total forecast turnover of €[…] million for 2008 breaks down by activity as follows: maintenance €[…] million; groundhandling services €[…] million; information technology €[…] million; shared services (staff and call centre) €[…] million ([41]).

([40]) As already indicated in point 38 of the decision to initiate the procedure, preference shares in the present case will represent at most 38 % of the share capital in 2008. Preference shares carry voting rights only in extraordinary general meetings and in ordinary general meetings concerning the distribution of dividends.

([41]) For information technology and shared services, the turnover excludes the internal services of AZ Servizi, that is €[…] and €[…] million respectively, which ought nonetheless to be taken into account in the case of transfer to a third party.

V.1.5.1. Advance billing for maintenance services

(116) The price construction method is essentially based on sector price comparisons taken from the independent study carried out by Aero Strategy ([42]). The expert described in detail the calculation method adopted for some aspects (for example 'heavy' maintenance and components of the A320 family, CFM56-5B jet engine maintenance) to verify the bases (frequency, hourly cost, number of hours, parts, etc). It also detailed the following two assumptions made for the purposes of this price construction:

a) application of a margin conforming to that currently used by Alitalia for services to third parties,

b) application of a volume discount rate lower than that normally obtained by AZ Fly from its maintenance suppliers; this rate, reduced from […] to […]%, reflects Alitalia's acceptance of higher prices and the absence of any commitments on volume. As regards the latter point, the expert was able to ascertain by tests that a contract with one supplier (Avio), which offered a maximum discount of 7,5 %, did in fact contain a minimum volume guaranteed by Alitalia. The annual effect of the discount rate reduction is equivalent to additional EBITDA for AZ Servizi, which would rise from €[…] million in 2005 to €[…] million in 2008.

V.1.5.2. Advance billing for groundhandling services

(117) The prices shown in the plan were estimated on the basis of the price which Alitalia pays at comparable airports ([43]), or of offers which the company has received at those airports where AZ Servizi will be operating ([44]). A margin of […]% negotiated with Fintecna was added to these prices. The annual effect of such a margin is equivalent to additional EBITDA for AZ Servizi, which would rise from €[…] million in 2005 to €[…] million in 2008.

V.1.5.3. Advance billing for information technology and shared services

(118) In the absence of any other information, Alitalia estimated the prices on the basis of offers from companies interested in acquiring such companies, and reduced in the same measure the discount rate being offered by those companies. The expert was able to confirm that this rate corresponded to the maximum being offered for shared services and to the minimum for information technology. Since these secondary activities each have similar turnover estimates (€62 million in 2005 in respect of the first and €64 million in respect of the second — excluding internal services — out of a total of €935 million), using the average of the two cases would not lead to very different results.

V.2. **Findings regarding compliance with the conditions for rescue aid**

(119) These findings are drawn from the additional checks required by the Commission in connection with alleged failure by Italy to honour the undertakings it gave when rescue aid was authorised on 20 July 2004. These undertakings involve refraining from new investment, ensuring that new routes being opened will be profitable and abstaining from predatory pricing; the use of loans secured by rescue aid was also investigated.

V.2.1. *Findings regarding refraining from new investment*

(120) The expert examined the structure of the fleet as at 31 December 2003 and 31 December 2004 and examined its trends. It concluded that only one aircraft, an Embraer 170, joined the fleet operating after 1 July 2004, in other words after the Commission had decided to grant rescue aid. Alitalia's Board of Directors had made the decision to acquire this aircraft on 19 June 2002, that is before 31 December 2002.

V.2.2. *Findings regarding analysis of the profitability of the new routes being opened from summer 2004*

(121) The expert concluded on the whole that, on the basis of the work carried out and taking into account the few exceptions found (described below), the situation as a whole did not suggest that Alitalia had failed in its undertaking to operate the new routes with positive operating margins.

(122) Since the profitability criterion used was the 'gross margin', the expert checked whether the factors taken into account might give cause for comment. The gross margin (or 'flight contribution') is defined as the (passenger or other) revenue generated by a given route, less commercial costs (commissions, etc.), distribution costs (CRSs and costs related to the sales structure and promotional initiatives charged proportionally against

([42]) MRO Market Forecast initiative — Component Maintenance Forecast 2003-2013 of 16 December 2003.

([43]) For example at Bologna for Palermo, Catania and Cagliari; at Malpensa for Fiumicino; at Geneva for London; at Düsseldorf for Brussels, Frankfurt and Athens.

([44]) For example at Naples.

the revenue from that route) and variable operating costs (for fuel, airport charges, in-flight service, flight crew allowances, etc.). The margin was evaluated from two different aspects: the direct margin generated by the passengers on the flight itself, and the margin generated by the 'feeder value' added to it, that is to say the margin created by passengers on that flight who are taking connecting flights with the same airline.

(123) The expert points out that, for a constant installed capacity (number of aircraft) arising from investments decided before 31 December 2002, the operating logic is one of decreasing marginal profitability, so that the extra resources freed up by better fleet utilisation (in particular for the period commencing winter 2004, in respect of which the expert refers to the data set out in point 47 of the decision to initiate the procedure) are necessarily earmarked for routes less profitable than those already opened.

(124) For routes opened in the summer of 2004, the expert checked profitability at end September 2004, the profitability forecast for end December 2004 and the profitability forecast in the 2005 budget. For routes opened as from winter 2004, reference was made to the latest forecasts for 2005. The conclusion is that, of the 25 maximum cases examined, all the actual profitability shown at end September 2004 (12 routes opened in summer 2004) or forecast in the 2005 budget for the 25 routes are already positive or, exceptionally, zero (two cases at end September 2004, one at end December 2004, one forecast for 2005); only three routes opened in summer 2004 show a negative direct gross margin at end December 2004. These cases are detailed below.

(125) The three routes with negative direct economic performance at end December 2004 are to Scandinavia:, Malpensa — Copenhagen (€[…] million at end December 2004 compared to €[…] million at end September 2004), Malpensa — Stockholm (€[…] million at end December 2004 compared to €[…] million at end September 2004) and Fiumicino — Stockholm (€[…] million at end December 2004 compared to €[…] million at end September 2004). All three are entered with positive margins in the 2005 forecast (€[…], €[…] and €[…] million respectively for the year). The expert related Alitalia management's comments on this, to the effect that these routes are exposed to heavy competition, including from low-cost airlines, and subject to high variable costs due to the length of the journey. Finally, as indicated generally, these routes were especially penalised by Alitalia's poor performance in autumn 2004 in terms of RATK (revenue per available ton-kilometre), which fell by 14,2 % in October 2004 compared to the previous months. The company's precarious financial situation, which led to a degree of loss of customer confidence, was thus found to be particularly significant on these new northern European routes, which required a greater effort to attract customer loyalty. However, the expert also points out that the information supplied by Alitalia indicates positive 'feeder values' for these three routes, the feeder value being the extra margin contributed in incremental revenue by passengers on these routes to Alitalia connecting flights to other destinations, in line with the company's hub strategy. For 2004 these feeder values are €[…], €[…] and €[…]million respectively ([45]); thus, in general terms, the operation of Alitalia's new Scandinavian network should remain profitable.

(126) The route with a zero direct margin forecast at end December 2004 is Fiumicino — Zurich (with €[…]million at end September 2004 and €[…]million forecast in the 2005 budget). It is characterised by powerful competitive pressure from Swiss, which operates four daily connections as opposed to only one operated by Alitalia. The route does, nevertheless, generate a positive feeder value (+ €[…] million) in 2004.

(127) By the same token, the route with a zero direct margin forecast for 2005 (Malpensa — Birmingham) generates a positive feeder value of €[…]million, with a net positive impact on the company's results.

V.2.3. *Findings regarding pricing practices on the new routes being opened from summer 2004*

(128) The expert carried out a number of analyses and checks on the new routes opened since the summer of 2004. It described the complex fares situation in the aviation industry, arising from the plethora of promotional offers, usually of one month, tied to various minimum and/or maximum stay rules, journey dates and times being changeable and tickets refundable, and the impact of reservation dates; it noted that the most attractive promotional rates are applied to a limited number of seats on each flight. Finally, the expert concluded, from the small number of exceptions found in terms of price leadership, that on the whole there was no evidence to suggest that Alitalia had reneged on its undertaking not to apply predatory prices on the new routes.

(129) The examinations relied on two sources: the documents supplied by Alitalia and checked by the expert, and the tests carried out on the expert's initiative on the Galileo computer reservation system (CRS) and on Alitalia's Internet site.

([45]) This value of €[…] million was calculated disregarding Alitalia's claim of possible improved performances in winter 2004.

V.2.3.1. *Tests carried out on Alitalia's data*

(130) It was possible to test each of the routes opened from the summer of 2004 onwards, either at the time of opening of the route or in March 2005; the tests involved return flight prices departing both from Italy and from the foreign city concerned. The prices indicated by Alitalia and its competitors were corrected to take account of the surcharge cost (SC) intended to cover the extra aviation fuel or insurance cost, which could vary greatly from one company to another, the purpose being to show the final price paid by the customer. The prices may be summarised as follows:

Alitalia data (€)	AZ	Competitor	Delta (€)	SC	Delta final (€)
Prices at opening of summer 2004 routes					
Zurich — Fiumicino	77	112	– 35	10	– 25
Prices at opening of winter 2004-2005 routes					
Timisoara — Malpensa	250	390	– 140	12	– 128
Shangai — Malpensa	513	533	– 20	19	– 1
Salonicco — Fiumicino	130	170	– 40	19	– 21
Prices in March 2005 of winter 2004-2005 routes					
Malpensa — Zagabria	169	199	– 30	22	– 8
Timisoara — Malpensa	129	149	– 20	12	– 8
Shangai — Malpensa	461	533	– 72	19	– 53

Note: SC: surcharge cost

(131) Only one of the 12 routes opened in the summer of 2004, entailing 24 tests, only one (Zurich-Fiumicino) showed an Alitalia fare (SC included) at the time of opening of the route €25 lower than that of the competitor, Swiss. In this connection, Alitalia argued that the difference in the price was justified by the difference in the type of product, having a much lower flight frequency than its competitor of one to four.

(132) By March 2005, of the 12 routes opened in summer 2004 (24 tests), none was any longer found to have Alitalia fares (SC included) lower than those of its cheapest rival. In the case of Zurich — Fiumicino the final price currently paid by Alitalia customers is higher than Swiss's fares.

(133) Of the 11 routes opened in winter 2004 (22 tests), there are three routes with Italian destinations (Timisoara and Shanghai — Malpensa, Saloniki — Fiumicino) offering an Alitalia fare (SC included) lower than competitors' prices at the time of opening of the route:

a) for Timisoara — Malpensa the price difference compared with Austrian Airlines (OS) is €128. However, Austrian Airlines' price of €390 seemed high compared with the fare charged by that airline for departures from the same city to Amsterdam, Gothenburg, Geneva, Helsinki or Luxembourg (€249 instead of Alitalia's €250 to Malpensa). The expert also put forward Alitalia management's explanation that Carpatair, a Romanian airline not in Galileo, offers Timisoara — Orio al Serio (Milan-Bergamo airport) one-way for €70, so that a return ticket would cost €140, more than €100 below Alitalia's fare;

b) for Shanghai — Malpensa the difference is negligible (€1 for a fare of more than €500);

c) for Saloniki — Fiumicino it is €21, comparing Alitalia's price (SC included) with that of Olympic Airlines, which offers €85 one-way, or €170 return. This observation applies only to departures from Greece, since the Alitalia flight from Italy is more expensive due to the SC which adds an additional €5 to the Alitalia flight.

(134) Two of the 11 routes opened in winter 2004 (22 tests), which fly to Italy (Timisoara and Shanghai — Malpensa), as well as the Malpensa-Zagreb link, show an Alitalia rate (SC included) lower than its competitor's in March 2005. According to the expert, Alitalia management ascribes the difference to limited-duration promotional fares linked with increased frequency:

a) for Timisoara — Malpensa the difference compared with competitors is reduced to €8. However, the competitors (Alitalia, Tarom, Malev) have had to cut their prices by some €130-150 (net of SC) due to the abovementioned presence of Carpatair, which is offering Orio al Serio at €140;

b) for Shanghai — Malpensa the divergence is increased to €53 due to Alitalia's price reductions compared with Lufthansa and KLM; flights to this destination are now five times a week instead of three;

c) for Malpensa — Zagreb Alitalia offers a price (SC included) €8 below that of its competitor, Croatian.

(135) As regards the two routes opened in summer 2005 (Malpensa — Kraków and Sarajevo), in all four tests Alitalia's fares are higher than or equal to those charged by its competitors.

V.2.3.2. Tests carried out on the expert's initiative

(136) The expert carried out some 110 additional tests directly via Galileo on these new routes at different periods; generally the tests confirmed the data supplied previously by Alitalia, but the expert considers that three cases examined under different criteria could have generated a tariff advantage.

(137) The first case concerns Saint Petersburg — Malpensa, for which, in November 2004 and January 2005, Alitalia enjoyed a tariff advantage of €13 over CSA, not including Air France among its competitors because of their joint-venture agreements; in previous data, Alitalia had regarded Air France as its chief competitor. In any event, the expert observes that this price difference no longer exists.

(138) The second case concerns the Timisoara — Malpensa link, for which the difference compared with Austrian Airlines at the time of opening was €128. The expert notes that from 15 October to 30 November 2004, Alitalia was offering a fare of €149, that is a difference of €229 (SC included) compared with Austrian Airlines. He points out, however, the existence since September 2004 (and confirmed in February 2005) of a return fare equivalent to €140 offered by Carpatair on the Timisoara — Orio al Serio route.

(139) The last case concerns the Valencia — Fiumicino link for which, in November 2004, Alitalia had offered a promotional rate of €69, taken into account by the expert when carrying out its examination, while Alitalia had made its comparisons on the basis of a fare of €101; Alitalia thus enjoyed a tariff advantage of €22 (SC included) in the month in question; as mentioned above, this difference no longer exists.

(140) Finally, at the beginning of April 2005 the expert carried out, at the Commission's request, a comparison between the prices Alitalia was offering between 17 and 22 March in Galileo (the basis of the previous tests) and those it was offering directly on its Internet site. Only two cases (Rome — Boston and Milan — Washington) showed a €10 difference, while the other prices had been confirmed. Since Alitalia management had given its assurance that it was not company policy to operate price differences according to sales channel and since the differences found were only slight, the expert concluded that they were due to the difference in time between the two checks.

V.2.4. *Findings regarding the use of loans secured by rescue aid*

(141) With the help of Alitalia the expert analysed the situation as regards the loan guaranteed by rescue aid, its use in 2004, its use in the first quarter of 2005 and the cash flow forecast for end 2005.

V.2.4.1. General remarks on the bridging loan and the cash assets

(142) As mentioned in the rescue aid decision, the expert pointed out that the cash flow forecasts used for rescue aid were to a large extent derived from the fourth quarter 2003 and first quarter 2004 data. When the decision was adopted, the company was in an *impasse* after the 2004-2006 industrial restructuring plan foundered in the face of trade union opposition to the measures proposed in it. This had led to the resignation of the managing director in February 2004, to his replacement and to the implementation of a new plan in September-October 2004.

(143) The expert also mentioned that the €400 million loan agreement signed with Dresdner Bank AG on 11 October 2004 was in pursuance of the guarantee decree of the Ministry of Finance of 8 October 2004. The expert recalled that the company's board of auditors had made activation of the loan conditional on calling a meeting of the shareholders to discuss the recapitalisation of the company. This meeting, which decided on a maximum capital increase of €1,2 billion, took place on 15 December 2004. Alitalia was not therefore in a position to make use of the bridging loan before that date. Dresdner Bank, on the other hand, reminded Alitalia by letter of 14 January 2005 that the loan had to be taken up by 31 March 2005.

(144) Furthermore, the expert compared the cash flow situation presented for the purposes of this procedure with that published by the company monthly as required by Consob ([46]). The expert showed that the situation as presented here reflects funds actually available in Alitalia group bank accounts on the value date. Conversely, Consob's monthly cash flow report is calculated on the accounting date and comprises short-term financial credits, including appropriations to Italian firms either in liquidation (like Sisam) or not covered by cash management (like Aviofin) and the unusable assets in the hands of an insurance broker, Alinsurance, in US travel agencies not covered by cash management and in companies located in countries (such as Libya, Iran, Nigeria, etc.) which have systems for controlling financial transfers to foreign countries. Altogether these items amount to a total of €22-25 million, which increases, without constituting available assets, the available assets and short-term financial credits submitted as required by Consob.

V.2.4.2. Use of the bridging loan in 2004

(145) In the fourth quarter of 2004, the cash flow net of variation in demand for working capital and net of investments (operational and investment cash flow, hereinafter referred to as 'cash flow'), reached -€54 million compared with the -€187 million forecast in July 2004; €80 million ([47]) of this €133 million improvement stems from the improvement in operational management compared to financial year 2003, used for calculating the aid, and from €20 million in revenue from tax credits 1993-1994 from the State, from €20 million in payments due but not made, to airport suppliers following legal action and, finally, from €4 million received as a contribution ([48]) by the Atitech subsidiary for the construction of a hangar at Naples airport. The lower negative balance (€53 million thereof ([49])) is also due mainly to the reduced need for investment; for example, in addition to unrealised planned investments, in November 2004 Alitalia carried out one of the five planned sale and lease-back transactions of MD-11 aircraft for €17 million. After repayment of due debts amounting to €49 million, the cash needs of €103 million for the quarter were met by means of a withdrawal of €100 million from the bridging loan after 15 December 2004.

V.2.4.3. Use of the bridging loan in the first quarter of 2005

(146) In the first quarter of 2005, from an initial figure of €66 million at 31 December 2004 the cash flow in July 2004 was -€70 million instead of the -€195 million forecast; some €60 million of this €125 million improvement stems from the continued improvement in operational management over the forecast used for calculating the aid; the figure also takes into account the favourable effects of a lower-than-forecast fall in unit yield and an improved load factor. Another €60 million is derived from the continued fall in investment costs: this includes the effect of another two of the five MD-11 sale and lease-back transactions planned and the sale of three Pipers for €30 million, the transfer of shares for €10 million and a €20 million reduction in the investment programme. The total financial need for the quarter therefore comes to about €105 million, including the repayment of €35 million of due debts; the bridging loan was nevertheless activated for the remaining €300 million (€55 million in February and €245 million in March), generating €262 million in available funds at 31 March 2005.

V.2.4.4. Cash flow forecast up to end 2005

(147) In the short term, the expert's Alitalia forecasts show only a slight fall in cash flow to €212 million at 31 May 2005; management improvements and lower investment, together with a fourth MD-11 sale and lease-back transaction will continue to bring benefits. Nevertheless, by the end of 2005 forecast cash flow, net of the impact of the possible recapitalisation, is expected to halve to €[…] million.

(148) The expert refers to one of the justifications given by Alitalia in connection with using the loan in its entirety at 31 March 2005, that is to say that, as mentioned by Dresdner Bank AG, it would not be possible to resort to it after 31 March 2005. The expert also emphasises one of the scenarios adopted for the purposes of these forecasts, that of October 2004 where the €/$ exchange rate is 1,27 and the price of a barrel of Brent is 41 USD.

([46]) The *Commissione Nazionale per le Società e la Borsa*, the Italian securities market regulatory authority.

([47]) Cash flow of -€60 million compared to the -€140 million forecast.

([48]) Source: Law No 488/1992, approved by the Commission as a regional State aid scheme on 2 August 2000 under number N 715/99. This scheme, which expires on 31 December 2006, excludes the transport sector, but Atitech, a subsidiary of Alitalia, is a company whose object is aeronautical maintenance; the company requested State aid in December 2000 and approved in 2001; the work was completed in December 2003 and payment of the aid was requested, on this basis, in September 2004.

([49]) Cash flow of +€6 million compared to the -€47 million forecast.

This scenario is unrealistic set against the current Brent crude price of $55-57/bl. The forecasts provided by the expert and three market players (BP RiskManager, Shell Trading and Macquarie Energy) indicate a figure ranging between $54 and $58 by end 2005. It has been calculated that, with a barrel price of $55 and a €/$ rate holding at 1,27, the negative impact on Alitalia's accounts would be of the order of €[…] million by the end of the year, [50] or, in other words, about €[…] million for the April-June quarter. This shows that Alitalia's current cash flow forecast is highly exposed to this volatility, all the more so since, when these forecasts were being put together in autumn 2004, Alitalia was prevented by its financial situation from taking any steps to cover exchange rate and oil price risk, so that any deterioration would therefore be fully reflected in its accounts. At present, the coverage operation merely seeks to stabilise the price at $55 and thus put a definite value on the loss.

VI. THE COMMISSION'S COMMENTS ON THE ALLEGED MISUSE OF THE RESCUE AID

(149) The Commission would point out that, in accordance with its decision to initiate the procedure in January 2005, the purpose of the present decision is to assess whether or not the AZ Fly and AZ Servizi recapitalisation measures notified by Italy should be regarded as State aid.

However, even if the decision to initiate the procedure is silent on this matter, in view of the observations received from interested parties the Commission wanted to give them the opportunity to make comments on compliance with the undertakings given by Italy with regard to the rescue aid and the procedures for using it. On the basis of these elements and with a concern for transparency, it sets out in this section its preliminary analysis of this question. In any event, as long as the bridging loan has not been repaid, or the State guarantee granted in this connection has not been withdrawn, Alitalia remains subject to the same conditions and undertakings; this part does not therefore prejudge the Commission's final assessment on this matter, in particular its option either to refer the matter directly to the Court of Justice under Article 88(2) of the EC Treaty or to initiate a procedure for misuse of rescue aid if it subsequently considers that there are grounds for considering that there has been such misuse.

The Commission would point out that one of the principal conditions of accepting rescue aid is that it should not have serious detrimental spillover effects on other Member States. To this end, as indicated in the rescue aid decision, the Italian authorities had given undertakings concerning the development of the company's capacity and the absence of predatory pricing on the new routes. These two questions are examined in points 150 to 172.

VI.1. Comments concerning the lack of new investment and capacity

(150) The Commission takes note of the conclusion of the expert appointed by it that, at the time of the expert's report in April 2005, Alitalia's fleet had not been increased by any new aircraft the acquisition of which had not been decided upon by the company before 31 December 2002. In particular, in reply to comments by the interested parties, it would point out the decision of Alitalia's Board of Directors of 16 February 2004, as mentioned in the decision to initiate the procedure [51] only concerned the arrangements for financing aircraft the acquisition of which had been decided upon before 31 December 2002. The Commission notes that the fleet referred to is that of the entire Alitalia Group, including Alitalia Express.

(151) The Commission therefore considers at this stage that it has not encountered elements prompting it to think that this specific undertaking contained in the rescue aid decision has not been complied with.

(152) Quite apart from the actual content of the decision authorising the rescue aid in terms of capacity which it was recently confirmed has been properly complied with, the Commission also takes note of the clarifications provided by Italy concerning more general concepts concerning capacity; so far as concerns the fleet, it finds that, apart from the lack of new investment, the fleet should in fact be reduced by four units in 2005. Accordingly, the available tonne-kilometres offered (TKO) leading to the increase in frequencies and seats between summer 2004 and summer 2005 noted by the competitors is simply the result of increased productivity resulting from a much greater daily use of the existing fleet. Accordingly, the increase of nearly 15 % reported by the Italian authorities corresponds to the order of magnitude noted by its competitors. The ability to implement this capacity in practical terms is itself improved as a result of the significant increase in the aircraft utilisation rate.

[50] With an annual fuel cost rising from €469 million to €711 million.

[51] Point 48 of the rescue aid decision.

(153) However, the Commission considers that the rescue aid decision already took account of the opening of new routes ([52]) and approved them precisely because they were implemented on the basis of constant capacity and on routes which to a large extent were not operated or were operated on a monopoly basis. It was a question of allowing the company to use the new resources made available by means of a better rotation of the existing fleet and the constant number of seats available, which explains, as indicated above, the increases noted in terms of tonne-kilometres and seat-kilometres offered (TKO/SKO).

(154) The Commission therefore considers that, in the light of the information available to it at this juncture, the developments noted in terms of frequencies and routes opened are not contrary to its rescue aid decision of July 2004.

VI.2. **Comments concerning the analysis of the profitability of the new routes opened from summer 2004**

(155) On the basis of the data provided by its expert, the Commission has obtained confirmation that all the routes opened since summer 2004 were profitable, in most cases in terms of their individual financial contribution alone and in all cases where the feeder value is included, that is to say the additional gross margin generated by these routes on the rest of the company's network. The Commission considers that taking the feeder value into account is justified, especially for a company pursuing a hub strategy, since this additional contribution would not have existed if the routes in question had not been opened. Accordingly, all the routes, including the new Scandinavian network, seem to be making a positive contribution, which is in accordance with the rescue aid decision.

(156) The Commission also notes that the interested parties' allegations concerning the case of the Saint Petersburg-Milan route, which the competitors considered to be operating at a loss, would seem to be invalidated by the figures supplied. This line, which was opened in winter 2004-2005, is forecast to have a positive direct gross margin for 2005 of € […] million, without even taking into account the feeder value, that is to say […]% of the income, placing it among the most profitable of the lines opened.

VI.3. **Comments concerning the analysis of pricing on the new routes opened from summer 2004**

(157) The Commission would point out that the existence of predatory pricing is primarily characterised by a situation in which the marginal variable income does not make it possible to cover the marginal variable cost, thus generating a loss. This question, which was examined in paragraphs 155 and 156, requires a complex and thorough analysis of the company's accounts, which the interested parties were not in a position to make. That is why, as indicated in its decision to initiate the procedure, the Commission had taken the view that a simpler comparison of the fares charges by Alitalia compared with the other companies (the existence of price leadership) could, initially, provide an indication as to the existence of situations could lead to predatory pricing.

(158) In this connection, the Commission has concluded, on the basis of the tests carried out, that, while situations of price leadership did in fact exist in a very small number of cases, for brief periods and with limited price differences, the fares charged on the routes in question would not seem to be predatory. As already indicated, the new routes are economic and most of the routes in question are among the most profitable according to the forecasts for 2005: that is the case with Saint Petersburg-Malpensa, which has already been mentioned, Malpensa-Zagreb, with a high gross margin of […]%, and Thessaloniki-Rome with almost […]%. Slightly less positive results were recorded for Rome-Zurich and Timisoara-Malpensa, with a […]% margin each, and Rome-Valencia with […]%.

(159) The Commission therefore considers that at this stage the very limited number, scale and duration of cases of price leadership established in the many tests carried out do not reflect a deliberate policy in this respect but are instead inherent in the very structure of air fares, their number and their constant updating. Furthermore, as the analysis of the margin obtained on the new routes has indicated, this situation has not affected the Alitalia's profitability; quite the contrary since the marginal variable income from the new routes for the company is higher than their marginal variable cost, which of itself confirms the lack of predatory pricing.

(160) The Commission therefore considers that, in the light of the elements in its possession at this juncture, the development noted with regard to the profitability of the new routes opened and the fares charged on them would not appear to be contrary to its rescue aid decision of July 2004.

VI.4. **Comments relating to the use of the loan guaranteed by the rescue aid**

(161) On the basis of the comments by the interested parties and Italy, and in particular the conclusions of its expert and the data available at present, the Commission notes that Alitalia is at present in a more favourable cash-flow situation than that expected when the rescue aid was adopted.

([52]) Point 37 of the rescue aid decision.

(162) This situation arises essentially from better control of operating costs and successful efforts to find alternative financing arrangements such as the abovementioned sales and lease-back operations. It also reflects the contribution to the results of the company of the new routes which, as indicated above, produce a profit margin. The Commission would point out, in reply to the interested parties, that the purchase of kerosene and the settlement of wages form part of the normal charges of an airline, influencing its cash flow or operating flow used when determining the aid.

(163) As to the principle, the Commission cannot but find it positive that a company faced with the necessity to redress its financial situation should seek to reduce its financial needs for the general benefit of its operation and credibility vis-à-vis new investors and find alternative financing arrangements. The Commission notes, moreover, that the dual effect of the reduction in investments and the efforts to find alternative long-term financing arrangements dispel any criticism relating to the financing of the fleet by means of the rescue aid and hence its use for an objective not in accordance with the decision authorising it.

(164) In this connection, the Commission notes that the late utilisation of the rescue aid, as from 15 December 2004 was in fact a condition imposed by the Audit Board at the start of the recapitalisation procedure in order to ensure that the company was not indebted without any prospect; by the same token, the gradual use of the aid would rather seem to be a sign of sound management. The delay in the use of the loan also indicates that since the development of the new routes took place on the basis of constant installed capacity and with a profit margin as indicated above, did not have a detrimental effect on the company's cash-flow situation compared with its forecasts but, on the contrary, helped to improve it. Similarly, the coverage of the future costs of the restructuring operations, essentially in terms of job-shedding, was budgeted for until 30 June 2005 and only gradually has an impact on the cash-flow situation as and when staff leave and sums due are paid.

(165) Consequently, the liquid assets of the Alitalia group as at 31 March 2005 amount to €262 million, or approximately €200 million above the figure as at 30 September 2004, that is to say €60 million ([53]). The Commission notes, as indicated by the expert (see paragraph 147), that this figure should be reduced by approximately €50 million by 31 May, the most favourable date for the closure of the procedure concerning the restructuring plan presented in accordance with the guidelines. The Commission would point out that this level of liquid assets of €262 million represents at most less than 6 % of the annual turnover, and is therefore very much lower than the figures previously presented by the company, of the order of €500 million at the end of 2003, and less than the average of 17 % for the main European companies as at that same date, which would represent €700 million for Alitalia. Alitalia's liquid assets therefore remain very stretched, whether in terms of gross figures or when compared with those of its main competitors. The Commission also notes that, all other things being equal, that is to say taking into account the financial efforts made in recent months by Alitalia but without the rescue aid, the company would, as at 31 March be in deficit to the extent of €262-400 million or approximately €140 million, rising to €190 million at the end of May. The Commission must therefore conclude that, but for the aid, the company would have had negative liquid assets and would therefore have been insolvent at the end of December 2004 ([54]). According to the Commission, there is nothing in the conduct of the company with regard to the utilisation of the bridging loan to show that the rescue aid was misused.

(166) The Commission would also point out that the assessment of the need for the aid had to be made at the time when the decision was taken and according to the information available at that time, which is what it did in July 2004. The Commission notes that much of what was known to the management of Alitalia at that date aroused deep concern about the state of the liquid assets from summer 2004. The Commission would point to the early cancellation by the Royal Bank of Scotland of a guarantee contract at the beginning of 2004 reported by the expert for €34 million; it would also refer to third-party documents provided by Italy which show that the company's major suppliers in terms of leasing, fuel and credit card sales operators required the provision of additional cash reserves and, where appropriate, guarantees in order to continue their commercial relations with Alitalia. This clearly shows the market's negative perception of Alitalia at that time and the assessment made by its management. The Commission had in fact accepted in the rescue aid decision that €40 million should be included to cover contingencies in this connection ([55]).

(167) The Commission also notes that these contingencies have not disappeared. Thus, the economic forecasts for Spring 2005 ([56]) published by the Commission on 4 April 2005 were based on the assumption of an oil price of

([53]) Situation presented to the Consob on 29 October 2004, or €83 million minus the €22-25 million of unavailable funds identified by the expert.

([54]) The situation presented to Consob on 31 January 2005 concerning 31 December 2004 indicated short-term financial loan availabilities of €91 million, i.e. after deducting around €25 million of unavailable funds and as presented by the expert (see paragraph 144), and a cash flow of €66 million after utilisation of a first tranche of €100 million of the bridging loan; otherwise the liquid assets would have been negative.

([55]) Point 16 of the decision of 20 July 2004.

([56]) http://europa.eu.int/comm/economy_finance/publications/european_economy/2005/ee205en.pdf

$50,9 per barrel and an €/$ exchange rate of 1,31 in 2005; on this basis, the recalculated annual charge for 2005 for fuel is approximately €625 million, representing an annual additional cost of approximately €156 million and €40 million for a single quarter.

(168) Thus, even taking into account what is known about present and future circumstances, the Commission, noting the negative liquid assets in the absence of the loan, since 31 December 2004, and the contingencies relating in particular to the price of oil, still considers the amount granted as being reasonable in the light of the uncertainties at the time. The Commission could therefore legitimately consider, at the time and without having its judgment affected by subsequent events, that the amount of €400 million was appropriate.

(169) As a result of this analysis, the Commission considers, first, that the rescue aid decision was fully justified and, secondly, that there was not at that stage misuse of the rescue aid. On the contrary, the rescue aid was necessary to maintain the company's business during the limited period covered by the authorisation and enable it to implement an industrial, economic and financial plan which was largely acceptable to its social partners, designed to ensure the long-term viability of the company.

(170) The Commission would point out to Italy, however, that the undertakings which it gave continue to apply for as long as the rescue aid remains; Italy must therefore continue to comply strictly with the Commission's authorisation of this aid and in particular ensure that Alitalia refrains from charging predatory prices on all the new routes opened since the 2004 summer season. In particular, Italy remains responsible for providing the Commission with the regular reports provided for in the rescue aid decision to enable it to assess compliance with the undertakings given. As for the repayment of the loan guaranteed by the rescue aid, the Commission takes note of Italy's abovementioned undertakings to intervene within eight working days following implementation of the recapitalisation of AZ Fly and, in any event, before 31 December 2005. The Commission takes the view that the date of implementation corresponds to the transfer of the corresponding funds to the company. It will be the responsibility of Alitalia as the aid beneficiary, and of AZ Fly for matters concerning air transport, as Alitalia's successor in this respect and thus still liable, as already indicated, for virtually all the present debt. The Commission will obviously continue to monitor the proper implementation of the rescue aid as part of its general State aid monitoring duties.

(171) Moreover, the Commission takes the view that the undertaking give by the Italian authorities that the State participation in Alitalia should become a minority holding in fact applies only to AZ Fly. This company will retain the legal personality of Alitalia, will assume virtually all the debt and in particular the bonded debt secured on aircraft and the loan guaranteed by the rescue aid; the undertaking given in the context of the latter to ensure minority public participation within one year is therefore linked to this. The Commission notes that the operations notified are also intended to ensure compliance with this undertaking.

(172) Lastly, the Commission takes the view that recapitalisation of the airline AZ Fly and the further analysis of the company's financial prospects that potential investors will inevitably carry out should, together, prompt the company scrupulously to respect the industrial plan thus presented; the Commission would point out in this connection that the plan makes provision for a recovery phase in 2005-2006 entailing guaranteed continued operation and a rapid return to balance from 2006, rather than expansion which would run counter to these objectives by, for example, resulting in a price war.

VII. ASSESSMENT OF THE EXISTENCE OF AID WITHIN THE MEANING OF ARTICLE 87(1) OF THE TREATY

(173) The Commission would point out that this final decision concerns the two recapitalisations notified by Italy in respect of which it initiated the formal investigation procedure on 19 January 2005, namely the State's participation in the recapitalisation of AZ Fly for a maximum total of €1,2 billion, and the increase in the capital of AZ Servizi envisaged by the State holding company Fintecna of €216 million.

(174) Moreover, the Commission notes that the support measures referred to in paragraphs 18 and 19 of the decision initiating the procedure and referred to as 'cassa integrazione' and 'trattamento di mobilità' are instances of pre-existing measures in Italian law being applied to the air transport sector which should, if necessary, be assessed as such for all the sectors of activity concerned.

Neither the notification nor the decision to initiate the procedure itself, in particular paragraphs 51 to 66 and 72 thereof, related to those instruments. This decision therefore does not prejudge the Commission's position with regard to the assessment of those measures in the light of State aid law. The Commission also notes that those measures fall within the framework of the obligations incumbent on the State as a public authority and with regard to the operation of the national social security system. Since they are completely different in nature from the capital contributions analysed in this decision they should not be included in the assessment of these contributions.

(175) Pursuant to Article 87(1) of the Treaty and Article 61(1) of the EEA 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, insofar as it affects trade between Member States, incompatible with the Treaty and with the EEA Agreement.

VII.1. **State resources**

(176) The Commission would refer to its analysis in point 63 of the decision to initiate the procedure with regard to the transfer of State resources to Alitalia. This analysis has not been called into question by the interested parties or by Italy. In particular, the Commission would observe that the details provided by Italy concerning the background to the relations between IRI and the State as well as their impact on Fintecna are simply intended as clarification and are in no way intended to dispute the designation of the funds to be provided by Fintecna as State resources or the fact that the operations in question are attributable to the State.

VII.2. **Effect on intra-Community trade and competition**

(177) The interested parties and Italy have not disputed the Commission's assessment in point 64 of the decision to initiate the procedure with regard to the effect on trade between Member States and the effect on competition, an assessment which the Commission maintains. The Commission would point out that the supply of air transport services is a sector in which there is keen competition in Europe since the entry into force of the third air transport liberalisation package ('third package') on 1 January 1993 ([57]).

(178) As regards the complaints made by Italy concerning the time it took to adopt the final decision, the Commission would specify that, while it is perfectly aware of what is involved for Alitalia, the situation of keen competition on the air transport market requires it to make a particularly accurate investigation of the situation. The Commission does not consider that Italy has demonstrated that the continued operation of the airline would have been put at risk if its decision had not been taken before the end of May 2005. Lastly, the Commission notes, by way of example, that the revised plan for 2005-2008 adopted by the airline's Board of Directors on 14 April 2005 was not forwarded to it until 22 April which did nothing to expedite the investigation.

VII.3. **Specificity**

(179) Pursuant to Article 87(1) of the Treaty, in order to be regarded as State aid, a measure has to favour 'certain undertakings or the production of certain goods'. In the present case, the Commission finds that the measures in question, namely the State holding in the recapitalisation of AZ Fly or AZ Servizi by the State holding company Fintecna are intended only for those two undertakings.

VII.4. **Existence of an advantage for the beneficiary undertaking**

(180) As indicated in the decision to initiate the procedure, the assessment relates to the two separate operations described above, which concern two separate companies which operate on different markets.

(181) In this respect, the Commission finds that the separation between the air transport activities, AZ Fly, and the ground activities, AZ Servizi, of Alitalia is not specific to that particular undertaking ([58]). In the present case, Alitalia's consultant bank, Mediobanca, has in fact noted that in the case of AZ Fly this demerger could make it possible to focus on investors interested in the aviation sector on account of its current economic problems and growth potential; it will also make it possible for the undertaking, as already indicated in the decision to initiate the procedure, to vary part of its operating costs, which had hitherto been fixed, by concluding contracts for maintenance, handling, etc., a possibility which is particularly attractive in an economic downturn. Similarly, in the case of AZ Servizi, demerger should make it possible, according to Mediobanca, to create new business and growth opportunities which will be difficult to achieve by a company wholly owned by an air carrier. It should also be of interest to industrial or financial operators in a given activity which wish to continue to develop that activity but do not wish to find themselves exposed outside their reference area of activity.

([57]) Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers (OJ L 240, 24.8.1992, p. 1), Regulation (EEC) No 2408/92 (see footnote 6) and Regulation (EEC) No 2409/92 of the Council of 23 July 1992 on fares and rates for air services (OJ L 240, 24.8.1992, p. 15).

([58]) For example, in recent years, BMI British Midland has transferred its groundhandling activities to Go-Ahead to create Aviance, TAP has transferred its activities to Globalia, and Lufthansa has transferred its Globeground subsidiary to Penauille Polyservices.

(182) The Commission would also point out that this separation of activities and the accounting and financial implications are transparent. Accordingly, the business plan submitted to the investors concerns both aspects of the plan which specifies that Alitalia's debt, including the repayment of the loan which is the subject of the rescue aid, should be taken over virtually entirely by AZ Fly, and sets out the separation of the activities of AZ Servizi, the evaluation of the initial contribution of AZ Fly recently presented on Alitalia's website, Fintecna's proposed participation in the capital and the procedures for this, including recourse in part to preference shares. The Commission therefore considers that investors were able to make an informed opinion about the activities in which they are likely to invest, the foreseeable profitability of each of them and their future relations.

(183) Lastly, the Commission would point out, as indicated in its decision to initiate the procedure, that applying the principle of a private investor in a market economy is the only way to assess the absence of advantage derived from the two recapitalisation operations. It notes that this is a matter separate from the assessment of the rescue aid. The latter was intended exclusively, through a very short-term cash loan of a very limited amount (in particular in relation to the undertaking's short-term due dates, the usual level of liquid assets of comparable airlines, and the undertaking's balance sheet total) and moreover comprising a bank loan provided by Dresdner Bank and simply backed by a State guarantee, to overcome a short-term cash crisis which could, in itself, cause the undertaking to become insolvent. Conversely, the judgment of the investors (and of the banks guaranteeing the operation) during recapitalisations operations, which generate permanent resources for the undertakings concerned, is based on an economic assessment of the medium and long-term viability and intrinsic profitability of the company's activity; their objective is the future viability of the undertaking, through the results achieved, which depends on the credibility of its business plan, the industrial and commercial activities for which it provides and the management thereof. The Commission also notes that the undertaking given by the Italian authorities that Alitalia should repay the rescue aid immediately following recapitalisation will entail the early disbursement from the undertaking's assets of the €400 million liquid assets in question.

VII.4.1. *Assessment of the recapitalisation of AZ Fly*

(184) First and foremost, there is no doubt that the injection of capital which the recapitalisation operation, including the State's participation in conjunction with private investors, amounts to does in fact constitute a State resource within the meaning of the Treaty since the funds concerned derive from the Italian Treasury. Similarly, the decision to participate in the recapitalisation and to undertake to exercise, at least in part, its preferential subscription right has been taken up by the Italian Ministry for Economic and Financial Affairs.

VII.4.1.1. General

(185) The Treaty enshrines the principle of neutrality with regard to the system of property ownership in the Member States (Article 295 of the Treaty and 125 of the EEA Agreement) and the principle of equality between public and private undertakings. Pursuant to those principles, action by the Commission must be neither prejudicial nor advantageous to States or public establishments which provide capital for undertakings. The Commission must therefore investigate these capital contributions to undertakings in order to ensure that the Member States do not infringe the Treaty's rules on State aid.

(186) In order to determine whether State aid is involved, the Commission is authorised by the Court to base its judgment on the principle of an investor in a market economy, as confirmed in recent case-law ([59]). According to the case-law, in order to examine whether a capital injection constitutes State aid, account should be taken of the genuine possibilities for a beneficiary undertaking to obtain equivalent financial resources by having recourse to the normal capital market. State aid is not involved where it is a question of new capital being contributed in conditions which would be acceptable for a private investor operating under the normal conditions of a market economy ([60]).

(187) The conduct of the public investor should therefore be compared with the hypothetical conduct of a private investor, such as a private holding company or a private group of undertakings pursuing a structural, global or sectoral policy and attracted by prospects of longer-term profitability ([61]). A capital contribution necessary in order to ensure the survival of an undertaking experiencing temporary difficulties but which, where appropriate, following the implementation of the necessary measures would be in a position to return to profitability does not necessarily constitute aid if a private investor would have made the same analysis.

([59]) Cf. Case C-482/99 *France* v *Commission* (*Stardust*) [2002] ECR I-4397. See also the Opinion of Advocate-General Geelhoed in Joined Cases C-328/99 and C-399/00 *Italian Republic and Sim 2 Multimedia SpA* v *Commission* [2003] ECR I-4035.

([60]) Commission communication on the application of Article 92 and 93 of the Treaty to public shareholdings, Bulletin of the European Communities No 9-1984; Court of Justice of the European Communities, 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, op. cit. points 25 and 26.

([61]) Judgment of the Court of Justice in Case C-305/89 *Italy* v *Commission* ('Alfa Romeo') [1991] ECR I-1603, paragraph 20.

(188) Consequently, the Commission takes the view that a capital contribution from public funds does not constitute State aid where private shareholders take part in the operation first of all at least in proportion to their shares, secondly in conditions identical to those of a public investor and finally if the proportion subscribed by private investors is of real economic significance. This approach, based on the principle that contributions should be, has been consistently applied by the Court of Justice and the Court of First Instance ([62]).

VII.4.1.2. Application in the present case

(189) The Commission takes the view, first of all, that contrary to other cases that it has criticised, it is not a question here, in the case of the separation of AZ Fly and AZ Servizi, of a dismemberment aimed at leaving the accumulated debt in a public cocoon, while the economic activity itself is transferred to the private sector. On the contrary, and in accordance with the legal and economic situation of the undertaking, virtually all the debt, that is to say the bonded debt and the loans secured by aircraft, as well as the loan which is the subject of the rescue aid, will remain within Alitalia, renamed AZ Fly, which will continue the vast majority of the current activities of the company. The Commission notes, in this respect, Italy's undertaking with regard to the advance repayment of this loan within eight working days following the recapitalisation of AZ Fly, that is to say the transfer of the corresponding funds to the undertaking, and in any event before 31 December 2005.

(190) With regard to the recapitalisation of AZ Fly notified by Italy, the Commission finds that private shareholders are participating in it in fact more than proportionally to the number of shares currently held by those shareholders (38 %) and under the same conditions as the State as shareholder. The implementation of the undertaking by the Italian State to reduce its participation to 49,9 % of the company capital has resulted in Deutsche Bank agreeing, possibly in collaboration with another financial institution, to underwrite private investors to the extent of a maximum of €650 million, or approximately 54 % of the maximum proposed recapitalisation. Their shareholding in the capital increase will therefore be a majority one, in order to reduce the public participation to below 50 %. It is also specified in the letter of intent from Italy that the State will purchase the shares at the same value, to be determined jointly by AZ Fly and Deutsche Bank, and under the same market conditions as the private investors.

([62]) See the judgment of the Court of First Instance in Case T-296/97 *Alitalia* v *Commission* [2000] ECR II-3871, paragraph 81.

(191) The successful completion of the operation is therefore guaranteed by Deutsche Bank, a technically competent professional operator, which has assessed the risk inherent in the partial non-subscription of the shares. In this connection, the Commission has received a copy of the letter of intent dated 19 April 2005 sent to Alitalia by Deutsche Bank accepts to conclude a contract to underwrite or have underwritten the success of the recapitalisation operation. This practice is in accordance with what the Commission had agreed to in 2002 on the occasion of the previous market recapitalisation of Alitalia. The final guarantee contract will be signed once the conditions set out in paragraphs 195 and 196 have been verified and will constitute the final concrete undertaking by Deutsche Bank to supply the financial resources for the operation and to subscribe the shares issued or have them subscribed. The Commission takes note in this connection of the details given by the Italian authorities indicating that this preliminary contract is legally fully valid in this respect for the parties subject to compliance with the suspensive conditions.

(192) In the abovementioned letter it is proposed that the final guarantee contract will be concluded close to the beginning of the offer period and will contain the standard provisions and undertakings in force in this type of contract and in accordance with best national and international practices. Deutsche Bank and another bank will also take responsibility for involving other financial institutions in the guarantee, thus making it possible to establish a genuine guarantee consortium. The involvement of the banks is decisive for the success of the operation as a result of Alitalia's shareholding structure. The capital held by private shareholders is very fragmented; as a result, at present there is no private institutional shareholder in the company that could carry out an economic analysis of the operation and give its prior undertaking to participate, as the State has done.

(193) The Commission acknowledges that, in the case of companies with a very fragmented shareholding structure, recourse to one or more banks responsible for guaranteeing the operation is necessary so as to ensure the successful completion of a capital increase operation on the capital market. Only qualified financial intermediaries are in a position, on the basis of their detailed knowledge of the financial markets and the type of investments sought and in the light of a detailed study that they have carried out of the operation in question, to commit themselves in respect of the investment vis-à-vis private investors where newly issued shares are concerned, to the extent that they consider the operation reasonable and attractive for certain providers of funds. Alitalia clearly has a fragmented shareholding structure since no private shareholder holds 3 % of the shares; the only remotely significant participation is that of Air France with nearly 2 % of the capital.

(194) In order to present its offer, Deutsche Bank carried out an assessment of the company's strategy and profitability prospects. In addition, before concluding the final contract, it proposes to carry out a due diligence operation which any investor should carry out before initiating the operation. In this way the bank surrounds itself

with all the guarantees and securities enabling it to adjust its offer to the risks taken. It should be noted that this bank has neither a management link nor a shareholding link with the Italian economic sector, and that it is not controlled, directly or indirectly, by the Member State concerned.

(195) The conditions to which the conclusion of the final guarantee contract are subject may be grouped together in two blocks, the first concerns relatively standard elements with no direct influence on the Commission's assessment but only on its actual implementation. They include:

a) the absence of extraordinary events which could be detrimental to the successful completion of the operation,

b) the transmission to the bank of complete information on the economic and financial situation and on the management of Alitalia, including the audited 2004 accounts and the updating of the 2005-2008 industrial plan,

c) the involvement of the bank in determining the procedures for the operation,

d) the demerger of AZ Servizi thanks to duly authorised capital injections by one or more undertakings.

(196) On the other hand, a second series of conditions set out in Deutsche Bank's letter of intent are liable to affect the assessment of the operation by the Commission; they should be analysed in detail. It is a question of:

a) the difference in the share issue price relative to the stock market quotation,

b) the commissions to be charged by the bank for the operation,

c) the exercise by the Italian Ministry for Economic and Financial Affairs of its preferential subscription right so as to enable it to reduce its participation in the capital to 49,9 %. The letter of intent specifies that this guarantee will obviously not cover the proportion of the shares which are the subject of the Ministry for Economic and Financial Affairs' preferential option right which must be subscribed by it so as to enable it to reduce its share of the capital of AZ Fly to 49,9 %.

(197) So far as concerns, first, the **subscription price for the new shares**, Deutsche Bank and AZ Fly have agreed that the price or price range for the issue of the new shares will be defined jointly in accordance with market practices in the light of the stock market conditions prevailing at the time of the launch of the operation. The difference between this price and the theoretical price taking account of the subscription right will be at least […]%. The Italian authorities have provided reference material drawn up by the bank enabling the Commission to ascertain that this difference is in accordance with market practices since 2003 for various European companies (in particular those undergoing restructuring) which have carried out recapitalisation in respect of a significant proportion of their share capital or of their value in terms of the daily stock market volume traded. The Commission therefore takes the view that this particular aspect does not present any particular difficulties. This of course is true only provided that all the shares issued are in fact subscribed at the same price by the various investors, that is to say the State, Deutsche Bank or other potential investors. Italy has in fact confirmed to the Commission that a single price will be charged for all the subscribers involved and that no specific discount will be granted to the guarantor.

(198) So far as concerns, secondly, the **remuneration of the banks through commissions**, the latter are based on the value of the proportion of the operation to be subscribed by the market, and amount to […]% for the commitment commission and […]% for the management and guarantee commissions, or [of the order of 5 %] of the total amount guaranteed. The Commission has been able to ascertain that this remuneration is in accordance with market principles on the main European stock markets so as to guarantee the successful completion of a comparable share placement operation. It notes that it is higher than the recapitalisation in 2002, although consistent with the normal level of remuneration, but acknowledges that this is attributable to the different nature of the operation, since only shares were involved in 2004 whereas both shares and bonds, presenting a lower risk, were involved in 2002, and to the fact that the proportion to be guaranteed is a majority one whereas in 2002 it represented 38 % of the operation. The Commission concludes from this that the transaction between Alitalia and Deutsche Bank is in accordance with market conditions for this type of operation and that it does not amount to a discount on the price paid by the bank for the shares that it will be called upon to subscribe. Consequently, the commissions paid to the banks do not have the effect of enabling them to participate in the operation on more favourable conditions than the State or the other shareholders.

(199) So far as concerns, thirdly, **the State participation**, the Commission would point out that the formal undertaking by the Italian authorities not to subscribe their share in Alitalia's capital increase until Deutsche Bank and any other participating banks have formally committed themselves is an essential decisive element

guaranteeing the existence of a concomitant participation of public and private shareholders. The State will participate in the capital increase only if there is a formal commitment by a private investor to make a capital contribution of real economic significance ([63]). This operation enables the private market to subscribe to a significant extent and even represent a majority holding (54 %) in respect of the shares newly issued by Alitalia under the same conditions as the public shareholders given that the share prices will be identical and the rights attaching to each share will be the same for all shareholders. In this connection, the Commission considers that it goes without saying that there cannot be collateral or implicit agreement whereby the Italian State would exonerate the banks from their obligation if the recapitalisation offer was insufficiently subscribed.

(200) The Commission also notes the undertaking given by the Italian authorities to transmit the final contracts with the banks (containing these formal and unconditional subscription obligations) to the Commission immediately after conclusion and before subscription of the new capital increase by the public authorities. A second undertaking given by the Italian authorities is to submit a report containing the actual subscription levels for this capital increase once the operation has been carried out. The Commission will pay the utmost attention to strict compliance with these undertakings by Italy so as to ascertain that the terms of the present decision will be properly adhered to.

(201) In this context, the Commission would stress the importance of Alitalia's industrial plan for 2005-2008 (including the revised version of April 2005) presented to the investors, which bases the future of the company on an initial 'recovery' phase in 2005-2006 prior to further development. Deutsche Bank has undertaken to guarantee the participation of a majority of private investors in the recapitalisation provided for in the plan on the basis of an analysis of this plan.

(202) The Commission would refer in this connection to the information already presented in the decision to initiate a procedure regarding this plan. The measures provided for in AZ Fly's restructuring plan should result, from 2005, in an increase of […]% of TKO (tonne-kilometres offered) together with an increase of […] percentage points in the load factor and […]% in the yield. In fact, over the first quarter of 2005, the accounts for which were submitted on 12 May, the TKO increased by 13,9 % and the load factor already showed a 0,2 % increase. The turnover for the quarter shows an increase of 9 %, or €77 million compared with 2004, with an increase in costs of only €36 million, or 5 %; even operating costs have fallen if fuel costs, which have risen by €45 million, are excluded; the operating loss is therefore only €120 million compared with €190 million in 2004. The operating loss estimated for the whole of 2005 is €100 million, that is to say that a profit is expected over the next nine months. The average staffing levels for the quarter (19 075 members of staff) have fallen by 1 617, two-thirds being ground staff, thus implementing the restructuring measures negotiated with the trade unions.

(203) More generally, the plan provides for an annual improvement of around €1 billion by 2008, including €200 million as a result of the load factor and some €770 million from other aspects of the plan; among the most significant improvements brought about by the latter are arise from savings on purchases, commercial expenses and staff expenses (€~ […] million per annum in each case).

(204) In terms of the outturn account, the data for 2004 and the following years are not comparable because of the spinning-off of AZ Servizi; nevertheless, after a small loss in 2005 in terms of pre-tax results and financial and exceptional factors ('operating result'), a margin of […]% is expected for 2008. (In 2004, for the same sectors, the margin announced on 26 May 2005 represents a loss of 10,1 %).

(205) The Commission would point out that, where a particularly qualified private investor is involved alongside the State, there is no call for the Commission to take a view as to the profitability of an operation. In the light of the undertaking given by the Italian authorities, it therefore concludes that the exercise by the shareholders of their preferential subscription right, together with the fact that the operation is underwritten by Deutsche Bank, is in accordance with banking practice in cases of recapitalisation in the Community, and can be treated as an operation by a private investor operating in a market economy, which moreover shows that the recapitalisation offers genuine market prospects. Given all these conditions, the Commission has decided that the investment notified by the State of a maximum amount of around 46 % of €1,2 billion is tantamount to the conduct of an investor operating in a market economy and does not therefore constitute aid.

([63]) See footnote 59.

(206) The Commission must nevertheless lay down the conditions attached to this decision, that is to say first of all the signature of an unconditional formal commitment by Deutsche Bank and any other financial institutions with the exception of the usual conditions concerning cases of force majeure, acts of war, terrorism and other similar cases, following due diligence checks and an agreement on the price. The State must also undertake to subscribe the shares on the basis of the same rights and under the same conditions, at the same price and at the same rate as priority investors, without prejudice to the implementation timetable proposed by Deutsche Bank and any other guarantor banks. Moreover, the operation must not be accompanied by any collateral agreement or implicit agreement whereby the Italian State would exonerate the banks from their obligation if the recapitalisation offer was insufficiently subscribed or granted the banks any specific discount on the issue price.

VII.4.2. *Assessment of the recapitalisation of AZ Servizi*

(207) So far as concerns the participation envisaged by the State holding company Fintecna of €216 million between 2005 and 2007 in AZ Servizi, the Commission would observe, first of all, that Fintecna is governed by ordinary law and that the State does not provide any specific or general guarantees in respect of it. The Commission also notes that Fintecna's liquid assets situation, which is favourable, as already noted in point 33 of the decision to initiate the procedure, is unconnected with any specific favourable treatment by the Treasury since, on the contrary, the loan of €788 million made by the former IRI to the State in 2000 and confirmed by Fintecna in 2003 still has to be paid back to that company in the next few months. These operations are in fact presented transparently in Fintecna's annual accounts.

(208) The Commission has reviewed the various reports presented by the parties involved in the operation, that is to say Mediobanca for Alitalia and Citigroup for Fintecna, and in particular its own experts, Ernst & Young. It notes that it did not have any reason to doubt the methodology of the evaluation carried out by Mediobanca which, on the basis of the investment of €216 million by Fintecna in the manner envisaged, leads to a final value, excluding cash flow, of €355 million in 2008, which produces an IRR of 25,3 %. Calculated otherwise, the net present value (NPV) of the investment to be made by Fintecna between 2005 and 2007, taking into account the same final value for 2008, and brought in line with the capital cost, that is to say 10,2 %, would be positive to the tune of €81 million; the operation therefore to a large extent creates value for Fintecna.

(209) Since such returns are highly dependent on use (€118 million of the €261 million capital brought in) of preferential shares held by Fintecna, the Commission observes, on the basis of the expert's findings, that recourse to this instrument would be subject to the limits set by Italian law. It would point out that the existence of a preferential right with regard to profitability offsets the limited voting rights at general meetings. Accordingly, with 69.7 % of the shares, Fintecna will have only 51 % of the ordinary voting rights. The Commission also notes the information provided both by the expert with regard to private Italian groups and by Italy in the case of other European companies to show that the use of shares of this type is widespread, including for significant parts of the capital of these companies, and does not give rise to any specific objections. Lastly, the Commission observes that only one investor, the State holding company Fintecna, will participate in AZ Servizi's capital increase so that the question of concomitance does not arise.

(210) The Commission also notes that the expert has compared the method and the results of the current valuations conducted by Mediobanca and Citigroup. These two bodies have used different approaches: Mediobanca has followed a global approach based on the capitalisation of the 2008 cash flow while Citigroup has approached valuation by sector of activity and the market multiples of EBITDA 2008, applying reducing coefficients where necessary; this also makes it possible to have a complementary validation of the value of the undertaking. The potential result normally expected by Citigroup, the investor's advisor, using this method has proved to be higher than that anticipated by Alitalia's Board used for this study ([64]).

([64]) In addition, the Commission notes that Fintecna's consultant, Citigroup, has analysed various scenarios corresponding to lesser degrees of achievement of the plan's objectives involving, depending on the method used, an upward adjustment in Fintecna's investment beyond the amount notified, and measuring the impact of this on profitability for Fintecna; the median value of these four scenarios, three of which are more unfavourable than the base scenario, still generates an IRR between 18,7 % and 27,1 % depending on the EBITDA multiple, notwithstanding the larger amount of capital invested. Account should be taken only of the worst case scenario, which forecasts the attainment of only 60 % of the efficiency targets and 85 % of the targets for increasing turnover from third-party customers, and associated with the lowest EBITDA multiples in the range for each activity, resulting in profitability of 9,1 % corresponding more or less to AZ Servizi's capital cost, Fintecna's being estimated at around one percentage point lower. Furthermore, the Commission's expert noted that, logically, Citigroup should have included the end-of-period liquid assets in its calculations, thereby improving the outturn.

(211) In its own verification of the valuation which, on the basis of the methods generally used in this connection, combines the activity-based approach and Citigroup's EBITDA multiples and an asset evaluation on the basis of fixed assets only for maintenance, the expert arrives, for the investment value notified, at a minimum value of 28,2 % above that calculated by Mediobanca.

(212) The expert also carried out a sensitivity analysis which shows that the key factor is the capital cost, regarded as correct in the cases considered. The Commission found that the abovementioned 10,2 % capital cost corresponds to a beta levered of 0,88 %, which is comparable to that of the reference quoted companies. AZ Servizi's debt, forecast at only 16 % of its financial needs, the balance being covered by its own funds, is on the low side; the Commission therefore wished to verify the impact of a beta of 1, which corresponds to that of the reference companies themselves, without reduction to take account of AZ Servizi's low level of indebtness; the capital cost would then be 10,75 % and the NPV for Fintecna still clearly positive at €52 million.

(213) If the higher beta applied to comparable companies, that is to say 1,32, is taken, without reducing it to take account of AZ Servizi's low debt, the capital cost would be 12,2 % and the final value for Fintecna, discounted to the capital cost itself, would still generate an increase in NPV of €19 million for Fintecna.

(214) Finally, on the most rigorous assumption, the capital cost would need to be 13,27 % to achieve the equilibrium NPV (stress test), that is to say the point where the forecast outgoing and incoming payments cancel each other out, or in other words the limit of profitability of the investment. This cost corresponds to an equity beta of 1,56 and a beta levered of 1,73 used for such valuations taking account of AZ Servizi's low rate of debt. This beta is well above those of all the competitors in the analysis carried out by the Commission's expert. It therefore considers that the threshold at which Fintecna's investment would become unprofitable is at a level such that it renders this risk highly improbable.

(215) The Commission notes, with regard to the matters still to be negotiated between Alitalia and Fintecna in respect of which it specifically asked its expert to carry out an impact assessment, that the coverage of any additional costs of the restructuring of AZ Servizi by AZ Fly, and the possibility of a premium for AZ Fly if the plan is fully successful with regard to AZ Servizi, are properly taken into account for the purposes of the valuation and are not such as to generate a reduction in IRR for Fintecna.

(216) The same applies to the possible payment of added value generated by the transfers by AZ Servizi to AZ Fly, provided that this only concerns added value which would not reduce the return on Fintecna's investment in AZ Servizi, excluding liquid assets, to below an internal rate of return (IRR) of 25 %. In this connection, the Commission takes note of the distribution that has now been agreed between the parties whereby a return for Fintecna in excess of the 25 % IRR envisaged in the business plan would be transferred to the extent of […]% of the part exceeding this figure. The Commission considers that, since this distribution only concerns the part of the return exceeding the target which is the subject of this decision, it will not affect its analysis. It considers that, in its capacity as a risk capital investor, Fintecna's objective of making a profit therefore falls within a well established range:

a) where the return for 2008 turns out to be lower than expected, the presence of preference dividend shares gives Fintecna a guaranteed minimum return; thus, the first €15,5 million of the net annual result will be assigned to it;

b) if, on the contrary, this return is very high, with an IRR in excess of 25 %, it will in any event exceed the target which Fintecna has set itself as investor and the partial redistribution is unlikely to reduce its return to below that figure.

(217) Fintecna's conduct is in this case indeed that of an informed risk capital investor seeking to limit its risk and having a precise profitability target informing its investment decision.

(218) At the request of the Commission, the expert also checked whether the future contractual relations between AZ Fly, as client, and AZ Servizi, as supplier, affect the future valuation of the latter. The Commission would refer to the extensive description of the analyses that it has carried out which conclude that, on the basis of the verifications carried out, there is no reason to doubt that such relationships will henceforth be based on market prices.

(219) However, the Commission wishes to clarify its analysis in respect of the findings of its expert on a number of points: the market references used in the plan to estimate the invoicing of maintenance and groundhandling activities have been corrected by a discount limited to […]% instead of […]% for the former, and an additional margin of […]% for the latter. In certain cases, these corrections are attributable to special circumstances, such as the absence of a long-term volume commitment. However, given the close link which exists and will continue to exist between the two undertakings, this explanation might not be sufficient. For 2008 these differences in margin generate a gain, in terms of EBITDA, of […] and […] € million, that is a total of some €[…] million, which amounts to a significant gain for AZ Servizi.

(220) However, the Commission also notes the findings of the expert and Italy in this connection that this additional margin is cancelled out, *de facto*, and is even negative in terms of owing to AZ Servizi's results owing to the provision relating to the premium to be paid to AZ Fly if the plan's objectives are achieved in full. This provision amounts to €[…] million of which €[…] million is chargeable in 2008, the year used for the valuation.

(221) The logic underlying this two-fold hypothesis is as follows: if AZ Servizi achieves 100 % of its efficiency targets, as set in the plan, the valuation carried out by Fintecna will be correct and there will no longer be any need for the additional margin from 2005 to 2008, which will have to be reassigned to AZ Fly; this is the assumption made and reflected in financial terms in the plan. If, on the other hand, the improvement and economy measures which have been to a large extent defined and negotiated and which the current management, that is to say Alitalia's management, has begun to implement, and to a certain extent 'sold' as such to Fintecna, are not entirely successful, Fintecna will then incur an additional charge in AZ Servizi's accounts which it will have the option of offsetting by reducing the discount or the margin by […]%. As far as the Commission is concerned, this arrangement, which does not artificially distort the valuation of AZ Servizi, is a normal arrangement between a former shareholder and a new shareholder called upon to co-participate in the capital of a company and also to manage a client-supplier relationship; it should give rise to a win-win situation on the part of the two stakeholders and should therefore be considered favourably.

(222) The Commission would specify in this connection that the analysis made of the business plan and the conclusion to which it has come on the basis of this analysis are based on strict compliance with the calculation and assumptions presented; accordingly, the rates, duration and procedures for, first, the efficiency premium to be paid to AZ Fly in the event of successful completion of the plan and in particular the maximum rate of […]% of incomings, and the reduction in the discount from […]% to […]% for maintenance and, secondly, the additional margin of […]% for handling must not affect the results of AZ Servizi's business plan and must therefore be kept in line with one another until 2008 or the complete withdrawal of Fintecna from the capital of AZ Servizi, whichever is the earlier.

(223) The Commission would also refer to point 36 of the decision to initiate the procedure which describes AZ Servizi's plan for 2005-2008 on which this valuation is based. This did not entail a particularly large increase in sales, which would only rise from €956 million in 2004 to €1 076 million in 2008, that is to say a 12,5 % increase in five years which, while suggesting that there will not be very high immediate returns, nonetheless means that, following a reduction in the EBITDA in 2005, the figure will once again be positive in 2006 and a clearly positive net result will not be achieved until 2008.

(224) The Commission therefore considers that the industrial plan as presented is serious, albeit described as demanding by the two parties, particularly by their advisors Mediobanca and Citigroup; it entails the continuation of the activity of AZ Fly, its main client, the success of the measures to make savings on purchase and staff costs, as negotiated with the trade union organisations, and which amount to €600 million over the lifetime of the plan and form the basis for the premium due to AZ Fly in the event of success.

(225) In conclusion, the Commission's analysis leads it to consider that the plan is sound and has been carefully examined by the parties, their consultants and its own expert. The €216 million investment by Fintecna in AZ Servizi is therefore tantamount to the action of an informed investor operating in a market economy and so does not constitute State aid. Nevertheless, the Commission will lay down the conditions to which this decision shall be subject.

(226) These conditions entail compliance with the following calculation parameters: the contractually agreed added value to be reassigned to AZ Fly shall not be transmitted unless all the proposed transfers have taken place, or on 31 December 2008 and according to the valuation carried out, and in either case only in respect of the part exceeding the forecast internal rate of return on Fintecna's investment, that is to say 25 %.

(227) The Commission would also point out that the proposed conditions for Fintecna's investment are acceptable for an informed investor in AZ Fly since the commitment by Deutsche Bank to underwrite the successful completion of the recapitalisation of AZ Fly has been entered into in full knowledge of the general business plan of the two undertakings, AZ Fly and AZ Servizi, and in particular Fintecna's abovementioned investment conditions.

VIII. **CONCLUSIONS**

(228) The Commission finds that the proposed recapitalisation of AZ Fly, the new designation of Alitalia and Fintecna's proposed investment in AZ Servizi in accordance with the precise procedures notified by the Italian authorities and analysed in this decision do not constitute State aid. The Commission can therefore authorise the procedures for the recapitalisation subject to the conditions set out below,

HAS ADOPTED THIS DECISION:

Article 1

1. The share of the recapitalisation of Alitalia (AZ Fly) notified by the Italian State and amounting to a maximum of approximately 46 % of €1,2 billion, that is to say approximately €550 million, does not constitute State aid.

2. In accordance with the principle of a private investor operating in a market economy, the operation described in paragraph 1 must take place in compliance with the following conditions:

a) recapitalisation will not take place until a formal unconditional commitment to underwrite the successful outcome of the operation has been signed by Deutsche Bank and any other financial institutions with the exception of the usual conditions concerning cases of force majeure, acts of war, terrorism and other similar cases;

b) the State's participation is authorised subject to the condition that it subscribes the new shares issued on the basis of the same rights and under the same conditions, at the same price and at the same rate as private investors, without prejudice to the proposed timetable for the underwriting by Deutsche Bank and any other guarantor banks of the successful completion;

c) the operation must not be accompanied by any collateral agreement or implicit agreement whereby the Italian State would exonerate the banks from their obligation if the recapitalisation offer was insufficiently subscribed or granted the banks any special discount on the issue price.

Article 2

1. The investment of €216 million by the public company Fintecna in the company AZ Servizi notified by the Italian State does not constitute State aid.

In accordance with the principle of a private investor operating in a market economy, based on the analysis of the viability of the business plan submitted to the Commission, the investment can be made only if the conditions referred to in paragraph 2 are complied with.

2. The contractually agreed added value which will have to be returned to AZ Fly may be transferred to that company only for the part exceeding the forecast internal rate of return on Fintecna's investment, that is to say 25 %:

a) once all the proposed transfers have been made, or,

b) in any event on 31 December 2008 and in accordance with the valuation of the rate of return.

Article 3

Italy shall provide the Commission with any reports and documents enabling it to verify:

a) compliance with the conditions referred to in Article 1 and 2, concerning both the participation of the Italian State and of Fintecna and third parties and particularly the final contracts with the banks and the reports justifying the subscriptions carried out in the context of these capital increases;

b) compliance with the commitment to repay the bridging loan within eight days of the recapitalisation of AZ Fly, and in any event by 31 December 2005.

Article 4

The Italian State shall inform the Commission within two months of the date of notification of this Decision of the measures taken to comply with it.

Article 5

This Decision is addressed to the Italian Republic.

Done at Brussels, 7 June 2005

For the Commission

Jacques BARROT

Vice-President