European Low Fares Airline Association

Rond Point Schuman 6 Box 5
B-1040 Brussels
Belgium

European Commission
Directorate-General for Energy and Transport
Directorate A, General Affairs and Resources
Building DM 28 – 1049 Brussels
Fax (32-2) 296 41 04

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STATE AID – ITALY
State aid No C 2/2005 (ex N 501/2004) – Alitalia: industrial restructuring plan
Invitation to submit comments pursuant to Article 88(2) of the EC Treaty

General Remarks

We refer to previous correspondence with DG Transport regarding ELFAA's concerns over the Commission's granting of a €400 million bridging loan to Alitalia and also concerns regarding the Italian Government's proposals to restructure the heavily loss making airline, despite the fact that Alitalia previously benefited from over €3 billion in state aid for the purpose of restructuring under the so-called "one time, last time" rule. However, none of this correspondence is reflected in the Commission's notice, despite the fact that similar complaints from other airlines and the UK authorities are mentioned. Attached are copies of this correspondence, along with various press articles and other evidence that ELFAA previously submitted to the Commission as part of its complaint.

ELFAA members currently serve over 150 routes into and out of Italy and have suffered from the serious distortion of competition in the Italian market due to the ongoing state support of Alitalia. This support is both direct and indirect through the underwriting of continuous losses, subsidised airport fees through state subsidised airport facilities over which Alitalia has exclusive use, the costs of which are not fully

recovered through airport fees charges, and PSO subsidies on routes that do not justify the application of Regulation 2408/92.[1]

The current proposals by the Italian government for restructuring Alitalia are a blatant infringement of the "one time, last time" rule and the fact that DG Transport does not even express "serious doubts" over these proposals is extremely worrying and demonstrates its predisposition in this case. The Notice states that *"the Commission cannot yet rule out the possibility that these recapitalisations constitute aid on the grounds that they do not comply with the principle of a private investor operating in a market economy"*. ELFAA would argue that no investor operating in a market economy would invest what amounts to over €3 billion[2] in a terminally ill national airline that has failed to restructure after a previous multi-billion state aid injection.

If the Commission were to correctly apply the state aid rules in this case, Alitalia, a clear example of a failing national company that has proven itself incapable of adjusting to a liberalised market, must be forced to exit the market. If the Commission fails in this case to properly enforce the state aid rules, it will further damage the air transport industry and the decision will be subject to legal challenge.

Specific Comments

The proposed restructuring is based on three main components; (1) Writing off €1.6 billion in debt by separating Alitalia into two companies – AZ Fly and AZ Services; (2) Underwriting 3,679 redundancies from AZ Fly at a cost of over €300 million; and (3) €750 million recapitalisation of AZ Fly.

(1) Writing off €1.6 billion in debt by separating Alitalia into two companies – AZ Fly and AZ Services. The separation of these two companies appears to be a blatant attempt to shift over €1.6 billion in accumulated debt/losses from AZ Fly to AZ Services. This massive write-off of the airline's debt is illegal state aid by any measure and must be prohibited. This is the same structure that Olympic Airways attempted in order to write off large accumulated losses and that the Advocate General of the European Court of Justice recently found to be illegal.[3] Again, it is disturbing that the Services of DG Transport have failed to find that these proposals raise serious doubts as to the validity of this plan under the State aid rules.

[1] This has most recently been demonstrated in the case of certain routes between Sardinia and the Italian mainland where the Italian authorities sought to tie 18 routes from Sardinia into one PSO package, thus foreclosing any competition from other carriers.
[2] This amount includes the €1.6 billion debt write-off for AZ Fly, the recapitalization of €1.2 billion and over €300 million in redundancy payments.
[3] Advocate General's Opinion of 1 February 2005 in Case C-415/03, Commission of the European Communities v Hellenic Republic.

(2) Underwriting 3,679 redundancies from AZ Fly at a cost of over €300 million. ELFAA fails to understand why the Commission does not even appear to question the 'Cassa Integrazione' that the Italian Government has *"extended to cover the aviation industry in order to limit the social repercussions of these measures"*. This is completely unacceptable and constitutes direct aid to Alitalia. An airline operating in the market economy would not have recourse to such support and the measure is therefore illegal state aid.

(3) €750 million recapitalisation of AZ Fly. Apart from indications that the Italian government allocated €750 million in its 2005 budget for this recapitalisation, this portion of the restructuring is completely unclear and it is questionable how the Commission can even make a decision on this issue given the current lack of information. The Notice states that *"However, in view of the fact that this notification has been made in advance, the bank's letters of intent announcing their willingness to guarantee the successful conclusion of the operation in terms of the involvement of private investors are not yet available."* The Notice also states that *"Other details of the operation, such as reducing the capital prior to recapitalisation to cover past losses, still have to be defined".* Similarly, with regard to the recapitalisation of AZ Services, the Notice states that *"certain aspects of the operation still have to be negotiated between the parties*."

Until the Commission receives this further information from the Italian Government, it is impossible for the Commission to properly consider this plan. It is also impossible for interested parties to properly comment on the proposals. ELFAA therefore calls on the Commission to insist on this information from the Italian Government before any further consideration of the recapitalisation is given. ELFAA also requests that interested parties are consulted on this information before any decisions are made. ELFAA also formally requests access to the file in this case as an interested party.

Violation of the Terms of the Bridging Loan

In addition to the fact that the proposed restructuring plan in no way complies with the Market Economy Investor Principle and also violates the "one time, last time" rule, Alitalia has also breached the conditions of its bridging loan. Rather than using the bridging loan to *"enable the company's financial needs to be covered until March 2005,"* Alitalia instead announced plans to expand its fleet and also to acquire a competitor. Alitalia also proceeded to open further routes. This is in clear violation of the conditions of the bridging loan and a further distortion of competition. Alitalia should therefore be forced to immediately repay this loan and to submit a liquidation plan to the Commission.

Conclusions

The Notice published by the Commission regarding the proposed recapitalisation of Alitalia is concerning in a number of respects. The so-called recapitalisation plan is no more than an attempt by the Italian government to write off over €1.6 billion in accumulated losses in Alitalia merely by splitting the company into two, and to underwrite over €300 million in redundancy payments to Alitalia employees. This is a clear violation of the state aid rules and entirely contrary to the "one time, last time" principle. It is also clear that no private investor would invest in Alitalia if they had to incorporate these huge debts and redundancy payments.

Furthermore, Alitalia has breached the conditions of the original bridging loan and should therefore be forced to pay this money and submit plans for a liquidation of the company.

The fact that the Commission does not even raise serious doubts concerning the Italian Government's proposals and has issued the notice before the Italian Government has submitted necessary information indicates that the Commission does not intend to vigorously apply the State aid rules. It is incumbent on the Commission to properly apply the state aid rules in <u>all</u> cases and not to be swayed by political pressure.

ELFAA wishes to receive copies of any further information to be provided by the Italian Government to ensure that the proposed recapitalisation does not lead to more state aid being granted to Alitalia and further distortion of the market.