

COMMISSION DECISION

of 22 July 1998

concerning the notified capital increase of Air France

(notified under document number C(1998) 2404)

(Only the French text is authentic)

(Text with EEA relevance)

(1999/197/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having, in accordance with Article 93 of the Treaty, given notice to the parties concerned to submit their comments by opening the procedure on 25 May 1994, and having regard to those comments,

Whereas:

I. THE FACTS

- (1) By Decision 94/653/EC⁽¹⁾ (hereinafter referred to as 'the 1994 Decision'), the Commission authorised the French authorities to grant to the Compagnie Nationale Air France (hereinafter referred to as 'Air France') State aid amounting to FRF 20 billion. The first two Articles of the enacting part of the Decision read as follows:

Article 1

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

- (1) the entire amount of aid shall benefit Air France alone. Air France means the Compagnie Nationale Air France, as well as any company of whose capital it holds more than 50 %, with the exception of Air Inter. In order to prevent any transfer of aid to Air Inter, a holding company will be set up by 31 December 1994 which will have a majority shareholding in Air France and Air Inter. No financial transfer which

does not form part of normal commercial relationships shall be made between the companies in the group, either before or after the actual setting up of the holding company. Accordingly, all transfers of goods and services between the companies shall be carried out at market prices; in no case may Air France apply preferential tariffs in favour of Air Inter;

- (2) the process of privatising Air France shall begin once the company's economic and financial recovery has been achieved, in accordance with the plan, having regard also to the situation on the financial markets;
- (3) Air France shall continue the process of implementing in full the plan as communicated to the Commission on 18 March 1994, in particular as regards the following productivity targets expressed by the indicator equivalent revenue passenger kilometre/employee for the duration of the restructuring plan:
- 1994: 1 556 200 equivalent revenue passenger kilometre/employee,
 - 1995: 1 725 000 equivalent revenue passenger kilometre/employee,
 - 1996: 1 829 200 equivalent revenue passenger kilometre/employee;
- (4) they shall adopt the normal behaviour of a shareholder *vis-à-vis* Air France, allowing the company to be managed in accordance with commercial principles alone and abstaining from intervention in its management for reasons other than those connected with its status as a shareholder;
- (5) they will not grant to Air France, in accordance with Community law, any new appropriation or any other form of aid;
- (6) they will ensure that, for the duration of the plan, the aid is used exclusively by Air France for the purposes of restructuring the company and not to acquire new holdings in other air carriers;

⁽¹⁾ OJ L 254, 30. 9. 1994, p. 73.

- (7) they will ensure that, during the period covered by the plan, Compagnie Nationale Air France does not increase the number of aircraft in its operating fleet beyond 146;
- (8) they will not increase, during the period covered by the plan, the supply of Compagnie Nationale Air France beyond the level reached in 1993 for the following routes:
- between Paris and all destinations in the European Economic Area (7 045 million available seat kilometre),
 - between provincial airports and all destinations in the European Economic Area (1 413,4 million available seat kilometre).
- The supply could be increased by 2,7 % each year, unless the growth rate of each of the corresponding markets is lower.
- However, if the annual growth rate of these markets exceeds 5 %, supply could be increased beyond 2,7 % by the amount of increase above 5 %;
- (9) they will ensure that Air France does not, during the period covered by the plan, apply tariffs below those of its competitors for an equivalent supply on the routes that it operates within the European Economic Area;
- (10) they will not grant preferential treatment to Air France in the matter of traffic rights;
- (11) they will ensure that Air France does not operate, during the period covered by the plan, more scheduled routes between France and the other countries in the European Economic Area than it did in 1993 (89);
- (12) they will limit, during the period covered by the plan, the supply of Air Charter to its 1993 level (3 047 seats and 17 aircraft), with a possible annual increase corresponding to the market growth rate;
- (13) they will guarantee that any transfer of goods or services from Air France to Air Charter reflects market prices;
- (14) they will ensure that Air France disposes of its shareholding in the Meridien hotel group by the end of the year on the best possible financial, commercial and legal terms;
- (15) with the cooperation of Aéroports de Paris, they will, as soon as possible, modify the traffic distribution rules for the Paris airport system in accordance with the Commission Decision of 27 April 1994 on the opening of the Orly-London link;
- (16) they will ensure that the work required to adapt the two terminals at Orly carried out by Aéroports de Paris, and a possible saturation of one or other of those terminals, do not affect competitive conditions to the detriment of the companies operating there.

Article 2

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

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

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

- (2) The 1994 Decision was contested before the Court of First Instance by British Airways, SAS, KLM, Air UK, Euralair and TAT, applicants in Case T-371/94, and by British Midland, applicant in Case T-394/94. On 25 June 1998 the Court of First Instance delivered a judgment in these two actions and annulled the 1994 Decision. The conclusions of the grounds for the judgment of the Court were as follows (point 454 of the Judgment):

'Examination of all the pleas in law raised in the present litigation has made it clear that the contested decision suffers from insufficient reasoning on two points, concerning, respectively, the purchase of 17 new aircraft for FRF

11,5 billion (see paragraphs 84 to 120 above) and the competitive position of Air France on the network of its non-EEA routes with the associated feeder traffic (see paragraphs 238 to 280 above). Those two points are of crucial importance within the general scheme of the contested decision. That decision must consequently be annulled'.

- (3) With regard, more specifically, to the insufficient reasoning concerning the purchase of 17 new aircraft, the Court of First Instance first recalled the case-law of the Court of Justice⁽²⁾ quoted by the parties concerned in the procedure through administrative channels preceding the 1994 Decision, according to which investment intended to ensure the renewal or modernisation, whether regular or normal, of the production capacity of an undertaking could not be financed through State aid. According to the Court of First Instance it appears that the 1994 Decision '... acknowledged that the aid was intended to finance the fleet investment involving the acquisition of 17 new aircraft ...' and that '... in any event, the decision did not preclude the possibility that the aid might be used, at least in part, for the purpose of financing such investment ...' since '... the only independent financial means at Air France's disposal designed to contribute to financing this investment, namely the disposal of assets, was expected to realise only FRF 7 billion, whereas the costs of the investment in question amounted to FRF 11,5 billion' (point 111). The Court considered that the acquisition of the 17 aircraft '... clearly constitutes a modernisation of Air France's fleet' and that in the reasons given for the 1994 Decision the Commission failed to specify whether it would tolerate, exceptionally, the financing of this acquisition through State aid because it considered the case-law quoted to be '... irrelevant in the specific circumstances of the present context or whether it intended to depart from the actual principle laid down therein' (point 112). It noted that the Commission's own decision-making practice reflected its opposition in principle to all operating aid intended to finance normal modernisation of installations, and concluded that:

'It follows that the grounds of the contested decision do not make it clear that the Commission did in fact examine whether, contrary to the above case-law and its own decision-making practice, the modernisation of the Air France

fleet could be partially financed by aid earmarked for restructuring of the company, and, if so, for what reasons' (point 114).

- (4) The Court of First Instance added that the argument presented by the Commission's agents that the aid in question was intended only to reduce Air France's indebtedness and not for the acquisition of the 17 new aircraft could not be upheld in that it was contradicted by the reasoning of the 1994 Decision and that it is for the College of the Commissioners alone to adopt any alteration to the statement of reasons. The Court also considered contradictory the reasoning according to which the restructuring plan was intended to produce a cash flow enabling Air France to meet its operating and investment costs and also the reasons for the 1994 Decision from which it was clear that the financial stability and profitability of Air France were not expected to be restored until the end of 1996 (point 119).
- (5) As for Air France's competitive position in the network of routes outside the European Economic Area (EEA) in regard to associated feeder traffic, the Court, having recalled that this question had been raised by some of the applicants in the administrative procedure prior to the adoption of the 1994 Decision, held that '... the statement of the grounds of the contested decision does not contain the slightest indication as to Air France's competitive position outside the EEA' (point 270). It emphasised that there was no analysis of Air France's international network and that the conditions of authorisation of the aid in terms of quantity and pricing practices covered only routes within the EEA even though the Commission, in a case connected with the application of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings⁽³⁾, made a relevant market analysis using the concept of substitutability of flights and Air France's restructuring plan expressly provided for the development of long-haul flights. From this, the Court concludes that '... having regard to that decision-making practice and bearing in mind the observations which the parties concerned made in that connection, the Commission was obliged to set out its views on the problem of non-EEA air routes served by Air France, the beneficiary of the authorised aid, in competition with other companies within the EEA' (point 273) and that as it did not extend the aforementioned conditions to EEA

⁽²⁾ Judgments of the Court of 24 February 1987 in Case 310/85, *Deufil v. Commission*, [1987] ECR 901, and of 8 March 1988 in *Joined Cases 62/87 and 72/87, Exécutif régional wallon and SA Glaverbel v. Commission*, [1988] ECR 1573.

⁽³⁾ OJ L 395, 30. 12. 1989, p. 1; corrigendum: OJ L 257, 21. 9. 1990, p. 13.

routes served by France, it '... was required to assess, in its examination of the relevant market, the potential substitutability of the non-EEA flights operated, for example, from Paris, London, Rome, Frankfurt, Copenhagen, Amsterdam and Brussels, and thus the potential competition, in regard to those flights, between the airline companies whose hubs are situated in any of those cities' (point 274).

(6) The Court adds that Air France's conduct on routes outside the EEA from its hub at Paris (CDG) airport may have repercussions on feeder traffic to that hub, possibly at the expense of feeder traffic to other hubs, and that the Commission ought therefore to have set out its views in the arguments for its decision, regarding the situation of the small airline companies which frequently depend on a few specific routes.

(7) The Court further notes that none of the requirements imposed by the Commission and associated with the 1994 Decision can make up for the fact that the Decision provides insufficient reasoning with regard to non-EEA routes. Nor does the Court accept, because it is not covered by collegiate responsibility, the argument put forward by the Commission and the interveners to the effect that the restrictions imposed on Air France for non-EEA connections, governed by bilateral agreements, would have benefited only non-EEA airlines and would therefore have been manifestly contrary to the common interest. The Court concludes that it cannot examine whether the arguments put forward on the effects of the aid on the competitive position of Air France in regard to its network of non-EEA routes and the associated feeder traffic are well founded, nor can it '... rule on the argument relating to Air France's pricing practices on its non-EEA network, allegedly operational measures financed by the aid' (point 280).

(8) The Court declared unfounded all the other arguments put forward by the applicants, including those relating to the allegedly incorrect course of the administrative procedure and those ensuing from errors of assessment and errors of law, in particular the alleged violation of the principle of proportionality with regard to the amount of the

aid, the change in trading conditions to an extent contrary to the common interest, and the inability of the restructuring plan to restore Air France's viability.

II. LEGAL EVALUATION

(9) Under Article 176 of the Treaty, 'the institution or institutions whose act has been declared void or whose failure to act has been declared contrary to this Treaty shall be required to take the necessary measures to comply with the judgment of the Court of Justice'.

(10) The Court has elaborated on these provisions as follows. 'The institution is required, in order to comply with the judgment and implement it fully, to have regard not only to the operative part of the judgment but also to the grounds which led to the judgment and constitute its essential basis, in so far as they are necessary in order to determine the exact meaning of what is stated in the operative part. It is those grounds which, on the one hand, identify the precise provision held to be illegal and, on the other, indicate the specific reasons which underlie the finding of illegality contained in the operative part and which the institution concerned must take into account when replacing the annulled measure' ⁽⁴⁾. The Court also emphasised that it is for the institution whose act has been declared void to determine the measures necessary to comply with a judgment annulling an act ⁽⁵⁾.

(11) In the present case, to take due account of the Court's judgment, it is for the Commission to adopt a new decision including the reasoning for the two points on which the Court found that there was insufficient reasoning. Moreover, as the 1994 Decision was annulled because of a breach of procedure, Article 176 does not oblige the Commission to reopen the procedure that led to the Decision and again go through the entire procedure before adopting a new decision. It appears from the established case-law that when an act has been annulled because of formal or procedural flaws, the institution concerned may take up the procedure from the stage at which the flaw occurred ⁽⁶⁾. In particular, as the Court stated in its judgment of 25 June 1998 (point 81), this Decision

⁽⁴⁾ Judgment of the Court of Justice of 26 April 1988 in Joined Cases 97/86, 193/86, 99/86 and 215/86, *Astéris and Others v. Commission*, [1988] ECR 2181, point 27.

⁽⁵⁾ Judgment of the Court of 5 March 1980 in Case 76/79, *Könecke v. Commission*, [1980] ECR 665, points 13 to 15.

⁽⁶⁾ Judgment of the Court of 13 November 1990 in Case 331/88, *Fedesa and others*, [1990] ECR I-4023, and judgment of the Court of First Instance of 17 October 1991 in Case T-26/89, *De Compte v. European Parliament*, [1991] ECR II-781, point 70.

must be based on the elements of fact existing at the time when the 1994 Decision was adopted, the Member States and the other interested parties have already had the opportunity to state their points of view in the administrative procedure preceding the adoption of the 1994 Decision and the procedural rights have therefore been respected, the Commission can adopt a new decision without reopening the procedure provided for by Article 93(2) of the Treaty.

- (12) As the Court recalled in its judgment of 25 June 1998, the statement of grounds required by Article 190 of the Treaty must disclose in a clear and unequivocal fashion the reasoning followed by the Community authority which adopted the contested act in such a way as to enable the Court to exercise its supervisory jurisdiction and the interested parties to know the grounds of the measure taken in order to be able to defend their rights⁽⁷⁾. Moreover, it appears from the established case-law of the Court that the question whether the statement of the grounds for a decision meet the requirements of Article 190 of the Treaty must be assessed with regard not only to its wording but also to its context and to all the legal rules governing the matter in question⁽⁸⁾. In this regard, while the Commission is not obliged to reply, in its statement of the grounds for a decision, to all the points of fact and of law invoked by the parties concerned in the course of the administrative procedure, it must nevertheless take account of all the circumstances and all the relevant factors of the case to enable the Court to exercise its supervision of legality and to inform the Member States and the nationals concerned of the conditions in which it applies the Treaty⁽⁹⁾.

- (13) In order to meet the abovementioned obligations on the two points which the Court found to be based on insufficient reasoning, the Commission wishes to point to the fact, first of all, that the aid granted to Air France is an aid for the restructuring of the company. In accordance with Article 92(3)(c) of the Treaty, the Commission holds that aids for the restructuring of undertakings in difficulty may

contribute to the development of certain economic activities without affecting trade to an extent contrary to the common interest. It is therefore for the Commission to ascertain, under the supervision of the Court, the discipline required to ensure that intervention by the Member States is not detrimental to the economic activities regarded as being in the common interest. In this exercise, the Commission has indispensable discretionary powers to identify and specify the conditions in which national intervention benefiting individual companies do not have the effect of shifting the difficulties of one Member State to another and may be considered as pursuing the common interest of developing activities in an economic sector. Past Commission decision-making in this matter has been highlighted from 1978 in its Eighth Report on Competition Policy: aid to companies in difficulty may be justified under the Treaty if it is subject to the achievement of a coherent restructuring programme designed to attain a long-term improvement of the situation and restore the competitiveness of these companies, and if it is confined to what is strictly necessary to preserve the company's equilibrium during the unavoidable transitional period before the programme bears fruit⁽¹⁰⁾. This approach was confirmed by the Commission's communication on State aids in the aviation sector⁽¹¹⁾, which continues the policy line followed by the Commission in its Decisions 94/118/EC⁽¹²⁾ *Aer Lingus*, 94/698/EC⁽¹³⁾ *TAP* and 94/696/EC⁽¹⁴⁾ *Olympic Airways*. It was set out in more general terms in the Guidelines on State aid for rescuing and restructuring firms in difficulty⁽¹⁵⁾.

- (14) In the abovementioned guidelines, the Commission states that restructuring '... is part of a feasible, coherent and far-reaching plan to restore a firm's long-term viability. Restructuring usually involves one or more of the following elements: the reorganisation and rationalisation of the firm's activities on a more efficient basis typically involving the withdrawal from activities that are no longer viable or are already loss-making, the restructuring of those existing activities that can be made competitive again and, possibly, the development of, or diversification to new viability activities.

⁽⁷⁾ Judgment of the Court of 14 February 1990 in Case 350/88, *Delacre and Others v. Commission*, [1990] ECR I-395, point 15.

⁽⁸⁾ *Ibid.*, point 16. See also judgment of the Court of 2 April 1998 in Case 367/95P, *Commission v. Sytraval and Brink's France SARL*, [1998] ECR I-1719, point 63.

⁽⁹⁾ Judgments of the Court of Justice of 24 October 1996 in Joined Cases C-329/93, C-62/95 and C-63/95, *Bremer Vulkan v. Commission*, [1996] ECR I-5151, point 32, and of 17 January 1995 in Case C-360/92 P, *Publishers Association v. Commission*, [1995] ECR I-23, point 39.

⁽¹⁰⁾ See paragraphs 227, 228 and 177 of the Eighth Report on Competition Policy.

⁽¹¹⁾ OJ C 350, 10. 12. 1994, p. 5.

⁽¹²⁾ OJ L 54, 25. 2. 1994, p. 30.

⁽¹³⁾ OJ L 279, 28. 10. 1994, p. 29.

⁽¹⁴⁾ OJ L 273, 25. 10. 1994, p. 22.

⁽¹⁵⁾ OJ C 368, 23. 12. 1994, p. 12.

Financial restructuring (capital injections, debt reduction) usually has to accompany the physical restructuring. Restructuring plans take account of, *inter alia*, the circumstances giving rise to the firm's difficulties, market supply and demand for the relevant products as well as the expected development and the specific strengths and weaknesses of the firm. They allow an orderly transition of the firm to a new structure that gives it viable long-term prospects and will enable it to operate on the strength of its own resources without requiring further State assistance' (paragraph 2.1). Where the Commission examines, pursuant to Article 92 of the Treaty, a restructuring operation involving a State aid, it must first determine if the restoration of the company may be regarded as an objective of its Community policy. Next, it ascertains whether the aid may restore the company to viability and whether the aid is commensurate with the costs and advantages of restructuring without engendering inappropriate distortion of competition. With this in mind, it may make a decision to authorise aid subject to compliance with certain conditions.

- (15) In the present case, the Commission took the view in its 1994 Decision that it is in the Community's interest to foster the success of restructuring Air France and ensure its long-term viability, and this view was not questioned by the Court (point 235 of the judgment).

On the reason concerning the financing of fleet renewal

- (16) In connection with the above, it should be pointed out that, with regard to the financing of the acquisition of new aircraft by Air France in the restructuring stage, company restructuring is based on an independent overall programme to restore the company's viability within a reasonable time-frame without the grant of any other aid⁽¹⁶⁾. It comprises the reorganisation and rationalisation of Air France's activities, planned cost reductions, giving up some loss-making routes, improving efficiency and productivity, sale of assets, reducing major financial burdens, all these being measures

without which the return to viability is bound to fail. All of these operations are partly financed through the recapitalisation of the company by a total amount of FRF 20 billion. This capital injection thus constitutes an indispensable element, inextricably linked with the overall restructuring of the airline, as is clear from the report compiled by Lazard Frères.

- (17) On account of the comprehensiveness of the restructuring operation and the indispensable nature of recapitalisation, the full amount of the aid is intended for the financing of the restructuring measures as a whole. These measures may be of various kinds: purely structural, such as the measures to reorganise the company's activity; social⁽¹⁷⁾, such as those relating to staff cuts (dismissal, retirement, etc.); financial, for example those intended to eliminate the company's accumulated losses or even cover losses realised during the restructuring period⁽¹⁸⁾. There may also be measures relating to the ordinary activity or the normal functioning of the company. In short, the nature of the co-financing measure through the aid is not decisive as it forms part of a restructuring plan that is likely to restore the company's viability, and the above-mentioned conditions of proportionality and the absence of inappropriate distortions of competition are fulfilled⁽¹⁹⁾. The acquisition of new aircraft forms part of Air France's overall restructuring plan and a failure to renew the fleet might jeopardise the viability of this restructuring exercise, as noted by the Commission in the 1994 Decision. The Court has recognised that the reasoning for this decision on the latter point was insufficient (point 102 of the judgment). The Commission is therefore of the opinion that there is no obstacle to the aid received by Air France being used to finance fleet renewal.

- (18) It is correct, as the Court points out (point 113 of the judgment), that for operating aids intended to finance normal modernisation of installations and relieve an undertaking of the expenses which it would itself normally have had to bear in its day-to-day management there can be no derogation from the prohibition laid down in Article 92(1),

⁽¹⁷⁾ Ibid.

⁽¹⁸⁾ See point 228 of the Eighth Report on Competition Policy.

⁽¹⁹⁾ Judgment of the Court of First Instance of 5 November 1997 in Case T-149/95, Ducros v. Commission [1997] ECR II-2031, point 65. See also the Commission's decisions published in full: ABB (OJ L 309, 13. 12. 1993, p. 21), La Papelera Española (OJ C 123, 5. 5. 1993, p. 7), Bull (OJ L 386, 31. 12. 1994, p. 1), Iritecna (OJ L 330, 13. 12. 1995, p. 23), Seda de Barcelona (OJ L 298, 21. 11. 1996, p. 14), SEAT (OJ L 88, 5. 4. 1996, p. 7), Compagnie Générale Maritime (OJ L 5, 9. 1. 1997, p. 40), Aircraft Services Lemverder (OJ L 306, 11. 11. 1997, p. 19) and the numerous Commission decisions not to raise objections, published in summary: for example, Bayerische Zellstoff (SG 93/D/18262), Polte (SEC(97) 1055), Magdeburger Stahlbau (SEC(97) 1271), Koenitz (SEC(97) 546/2), etc.

⁽¹⁶⁾ See note 11, paragraph V.2.38.

except if their distorting effects are counterbalanced by one of the objectives of common interest specified in Article 92(2) and (3)⁽²⁰⁾. This is the context of the reference to the Court's rulings in the Deufil and Glaverbel cases made by the parties concerned during the administrative procedure. In the present case, however, even if fleet renewal does not constitute initial investment and does not relate to additional or new equipment⁽²¹⁾, it does form part of a restructuring operation encompassing the elements detailed above, in contrast with the situation in the Deufil and Glaverbel cases.

(19) Furthermore, the investment considered in these two court cases had to be viewed in the context of a significant overcapacity on the markets in question and, in the Deufil case, the investment had enabled the company to double its production capacity. In the present case, however, the acquisition of new aircraft in no way increases Air France's supply in terms of greater seating capacity and the European aviation market was not suffering a structural overcapacity crisis in 1994 as illustrated below.

(20) Moreover, in the notification sent to the Commission on 18 March 1994, the French authorities stated that through the capital injection Air France's indebtedness would be reduced from FRF 34 billion to FRF 15 billion between the end of 1993 and the end of 1996. Lazard Freres' report appended to the notification presents the following development of Air France's equity capital and net debt over this period

(in billion FRF)

	1993	1994	1995	1996
Equity capital	(0,4)	7,1	11,7	17,4 ⁽¹⁾
Net debt	34,1	25,1	20,7	15,2 ⁽¹⁾

⁽¹⁾ Excluding capitalised rents amounting to FRF 6,9 billion and before conversion of ORAs (Obligations remboursables en actions) totalling FRF 1,25 billion.

The table shows that Air France's indebtedness should decrease by FRF 18,9 billion between the end of 1993 and the end of 1996. If account is

⁽²⁰⁾ Judgment of the Court of 15 May 1997 in Case C-278/95P, *Siemens v. Commission*, [1997] ECR I-2507, point 23, confirming the judgment of the Court of First Instance in Case T-459/93, [1995] ECR II-1675, point 48.

⁽²¹⁾ The concept of operational aid extended to replacement investment, mentioned in the Glaverbel and Deufil judgments, is not necessarily identical with that evolved by economic theory.

taken of the airline's additional indebtedness in the first half of 1994, the Commission takes the view that the aid granted to Air France, is in its entirety, intended to reduce the company's indebtedness, concomitantly with the increase of its equity capital, and not to finance the purchase of new aircraft. Moreover, the financing table included in Lazard Frères' report also shows that the operational resources obtained from the sale of assets (FRF 7 billion) and the self-financing capacity (FRF 12,1 billion), which not only includes the company's results but also depreciation, depletion and amortisation, are more than sufficient to cover operational requirements (FRF 14 billion), including FRF 11,5 billion for investment in aircraft. It should be pointed out, finally, that net expenditure on investment in aircraft does not amount to FRF 11,5 billion during the period covered by the restructuring programme, but to FRF 6,2 billion, of which FRF 3,5 billion for investment in aeroplanes alone, as the plan notified to the Commission makes provision for FRF 4,1 billion from the transfer of aircraft and FRF 1,2 billion from the sale of spare parts in 1994 to 1996.

The reasoning as to Air France's competitive position on non-EEA routes

(21) With regard, secondly, to Air France's competitive position on the network of routes to non-EEA countries, it should first of all be pointed out that the relevant markets defined by the Commission in a case concerning State aid are more general than those covered by its analysis in the competition cases referred to it under Articles 85 and 86 of the Treaty or Regulation (EEC) No 4064/89. The Commission's communication on State aid in the aviation sector states that the geographical market to be taken into consideration to limit the effects of aid on competition may be either the EEA market in its entirety or a specific regional market particularly subject to competition⁽²²⁾, whereas the Commission partly makes a route-by-route analysis by applying Articles 85 and 86 of the Treaty to civil aviation markets⁽²³⁾.

(22) The judgment of the Court of First Instance of 25 June 1998 confirms the validity of this approach. In its 1994 Decision the Commission refrained from carrying out a route-by-route examination within the EEA but addressed the question of Air France's competitive position on this market as a

⁽²²⁾ See footnote 11, point V.2.38.4.

⁽²³⁾ Judgment of the Court of 11 April 1989 in Case 66/86, *Ahmed Saeed Flugreisen and Silver Line Reisebüro v. Zentrale zur Bekämpfung unlauteren Wettbewerbs*, [1989] ECR 803, points 40 to 46. Judgment of the Court of First Instance of 19 May 1994 in Case T-2/93, *Air France v. Commission*, [1994] ECR II-323, points 45 and 80 to 85. Commission Decisions 92/213/EEC of 26 February 1992, *British Midland/Aer Lingus* (OJ L 96, 10. 4. 1992, p. 34); of 5 October 1992, *Air France/Sabena* (OJ C 272, 21. 10. 1992); of 27 November 1992, *British Airways/TAT* (OJ C 326, 11. 12. 1992); of 20 July 1995, *Swissair/Sabena* (OJ C 200, 4. 8. 1995, p. 10); 96/180/EC, *LH/SAS* (OJ L 54, 5. 3. 1996, p. 28).

whole. The Court accepted this Commission position both with regard to its reasoning (point 269) and the principle as such (point 288). The Commission therefore holds that it can undertake a similar overall analysis with regard to non-EEA routes.

- (23) With regard to the restrictions that may be imposed to limit distortions resulting from the aid or effects on trade between the Member States, the Commission's guidelines on State aid for rescuing and restructuring firms in difficulty provide that the restructuring plan must include a reduction in production capacity if there is structural overcapacity on the Community market in question. The situation is different, however, if there is no such overcapacity: 'Where, on the other hand, there is no structural excess of production capacity in a relevant market in the Community served by the recipient, the Commission will normally not require a reduction of capacity in return for the aid. However, it must be satisfied that the aid will be used only for the purpose of restoring the firm's viability and that it will not enable the recipient during the implementation of the restructuring plan to expand production capacity, except in so far as is essential for restoring viability without thereby unduly distorting competition' ⁽²⁴⁾. This approach is confirmed by the case-law, in which reduction of capacity is considered an acceptable remedy for distortions of competition ⁽²⁵⁾. However, on the subject of the proportionality of restraint mechanisms that may be imposed, the Court has recognised that no exact quantitative ratio needs to be established between the amount of the aid and the size of the required cuts in production capacity. The Commission's assessment cannot be subjected to a review based solely on economic criteria but may also '... take account of a wide variety of political, economic and social considerations' in exercising its discretion ⁽²⁶⁾.

- (24) In the present case, in order to prevent trade being affected to an extent contrary to the common interest, the Commission makes its decision to authorise the aid subject to compliance with the following main conditions: a commitment by Air France that it will use the aid exclusively for restructuring purposes; limiting to 146 the number of Air France's aircraft during the period covered

by the plan; limiting the supply of Air France in terms of seat/kilometre available within the EEA during the period covered by the plan; prohibition for Air France to act as a price leader within the EEA for the duration of the plan; no preferential treatment for Air France in terms of traffic rights; limiting to 89 the number of routes regularly operated by Air France between France and the other EEA countries. Of these various conditions, the absence of preferential treatment with regard to traffic rights and the limitation to 146 of the number of aircraft apply to all routes, including those to non-member countries. Within the scope of its overall discretionary powers, the Commission has seen fit not to extend the other abovementioned conditions to non-EEA routes, in particular the prohibition of price leadership and the limitation of the quantity of seat/kilometre available, for the following reasons:

- the existence of substantial guarantees for all routes
- the conditions of competition and intra-Community trade in 1994 were much more strongly affected by the development of routes within the EEA than by that of non-EEA routes
- extending the above conditions to non-EEA routes would essentially benefit airlines in non-member countries.

- (25) On the first point, the Commission takes the view that the commitment to use the aid exclusively for the purpose of restructuring Air France and the limitation of the number of aircraft, both of which conditions fully apply to non-EEA routes, are in themselves substantial concessions to be made by Air France in return for the aid. As demonstrated above, the FRF 20 billion capital injection must be regarded as used solely to reduce the debt, to the exclusion of any use intended to revert to tariff or other practices that are likely to lead to losses. The notified restructuring plan also limits the number of aircraft to 146 during the period covered by the plan, with concomitantly a slight reduction in the total number of seats available, and in its communication on State aids in the aviation sector the Commission specified that the programme financed by State aid must not be intended to increase the capacity and supply of the company concerned to the detriment of its direct European competitors and that at any rate the programme must not lead to an increase in the number of aircraft or seats available on the markets concerned in excess of the growth of these markets ⁽²⁷⁾.

⁽²⁴⁾ See footnote 15.

⁽²⁵⁾ Ducros, see footnote 19, point 67.

⁽²⁶⁾ Judgment of the Court of First Instance of 24 October 1997 in Case T-244/94, *Wirtschaftsvereinigung Stahl v. Commission*, [1997] ECR II-1963, point 111, referring to the judgment of the Court of Justice of 3 October 1985 in Case 214/83, *Germany v. Commission*, [1985] ECR 3053, point 33.

⁽²⁷⁾ See footnote 11, point V.2.38.4.

(26) In the 1994 Decision the Commission took the view that the European air transport market was not going through a structural overcapacity crisis and that the situation in the aviation sector did not justify an overall reduction of capacity. The Commission's reasoning on these two aspects was accepted by the Court of First Instance (points 365 and 367 of the judgment). It should be added here that civil aviation is one of the sectors where long-term growth has been strongest for the past 50 years. This growth even continued in the period 1990 to 1994 in which air transport went through the worst crisis in its history. As the Commission indicated in the 1994 Decision, the prospects for long-term growth are of the order of 6 % per year. In this context, the slight reduction in the total number of seats available from Air France during the period covered by the programme, which is tantamount to a freeze of its production capacity, appears on its own as a very serious limitation, in particular as there are no plans for partnerships with other major airlines. Forecasts of the trend of Air France's traffic on non-EEA routes in 1994 to 1996, communicated to the Commission in April 1994, show for each major region in the world a growth in Air France's traffic that is substantially lower than that for traffic as a whole, measured in terms of passenger-kilometres carried (e.g. [...] ⁽²⁸⁾ as against [...] for North America, [...] as against [...] for South America, [...] as against [...] for the Asia/Pacific zone, etc.). In practice, finally, the risk that Air France would benefit from the aid to deploy more capacity and put more planes on routes to non-member countries is very small in practice as, on the one hand, the capacity available to Air France on routes to non-member countries is regulated by bilateral agreements which cannot be changed without the consent of the other countries concerned, as indicated above, and on the other hand short- and medium-haul aircraft used on routes within the EEA can hardly be used to replace long-haul aircraft used for intercontinental flights which account for a very large proportion of non-EEA routes.

(27) With regard to the second point, it should be noted in general that the Commission logically focuses the restrictions imposed on Air France on routes within the EEA, where the effect of the aid will be strongest, since it has to ensure that this effect does not change the trading conditions to an extent contrary to Community interest. Moreover, the Third Aviation Package which entered into force

on 1 January 1993 grants full freedom to Community airlines to choose their own air fares, flight frequency and seating capacity on all routes within the EEA. However, the operating conditions of routes between the various EEA countries and non-EEA countries are still largely regulated by bilateral agreements which, except on certain transatlantic routes, strictly limit the quantities offered and the possibilities of air-fare variation. The risks involved in using a State aid to finance practices that distort competition are thus naturally much greater on routes within the EEA than on non-EEA routes. In its communication on State aids in the aviation sector, the Commission specifically indicated, in connection with relations with non-member countries, that market access conditions and the limitation of competition laid down by most bilateral agreements with non-member countries appear to be far more important economically than any State aids ⁽²⁹⁾.

(28) For instance, one third of the bilateral agreements in force in 1994 between France and countries outside the EEA include a sole designation clause limiting the number of airlines likely to be designated by France to a single one. Virtually all of these agreements comprise provisions restricting all or part of the services supplied (in terms of flight frequency, seating capacity, etc.) by the airline or airlines designated by each party. Only a very small number of bilateral agreements concluded by France do not lay down a specific provision limiting supply. The France-USA relationship is a special case as, since the termination in 1992 of the aviation agreement by which their relationship was governed, the capacity made available by each airline required approval by both parties for each scheduling season. Air fares are completely governed by the bilateral agreements concluded by France, as they are almost systematically subject to the principle of double approval by the States concerned ⁽³⁰⁾. Finally, all of these bilateral agreements confine possible designation to airlines largely owned and effectively controlled by French nationals.

(29) Among the routes outside the EEA that may be affected by the grant of the aid to Air France, a distinction should be made between direct flights

⁽²⁸⁾ This version of the Decision has been edited to ensure that confidential information is not disclosed.

⁽²⁹⁾ See footnote 11, point II.2.11.

⁽³⁰⁾ See the *Digest of Bilateral Air Transport Agreements* published by the International Civil Aviation Organisation.

between France and non-EEA countries, on the one hand, and flights between other EEA countries and non-EEA countries following an indirect route via the Paris-CDG hub.

- (30) On the markets constituted by flights between France and non-EEA countries, Air France is in practice not in direct competition with other non-French Community airlines because of the restrictions imposed by bilateral agreements regarding the air carrier's nationality. The sole designation provision included in many agreements also prevents the designation of French airlines in competition with Air France. The fact is that even if another French airline were to enter the market as a result, in particular, of the condition precluding all preferential treatment of Air France, the other restrictions imposed by bilateral agreements concerning prices and capacities offered limit very strictly the conditions of competition. It is emphasised that the system of dual approval of air fares in practice precludes all risks of predatory air fare practices by one of the designated airlines on an extra-Community route, which removes the possible useful effects of a prohibition on price leadership. A limitation of capacities made available by Air France on extra-Community routes would hardly be more useful as price controls make it much less interesting for an airline to increase considerably the number of seats available on these routes, even assuming that the bilateral agreements allow such an increase. Particularly on the North Atlantic market, which is by far the most important intercontinental market for flights from France, control exercised by the French and American authorities since 1992 has in effect sought to limit the trend toward increasing seating capacity.

- (31) On the markets made up of indirect flights via Paris-CDG between other EEA countries and non-EEA countries there is a certain competition between Air France and its principal Community competitors also operating hubs. However, the conditions of this competition are likewise limited by restrictive provisions of bilateral agreements concluded between EEA member countries and non-member countries, whose effects have been explained above. These agreements usually do not allow a 'second freedom' airline to act as a price leader in air fares. Moreover, the services in question are only partly mutually substitutable since a direct link is hard to compare with an indirect flight involving waiting time in transit, often a change of planes, and sometimes a transfer to

another terminal building with luggage-processing risks. The Commission is of the opinion that there is a certain degree of substitutability between the Paris-CDG hub and other hubs located in the Community on the relevant markets for the segment of customers mainly interested in low air fares, i.e. essentially tourists. This substitutability, however, is only very slight for business passengers, who are mainly interested in travelling time, punctuality and quality of service. It is for the business passenger segment that airline margins are the most significant and risks of distortion of competition through improper use of aid the most pronounced.

- (32) It should also be mentioned that in 1994 Paris-CDG airport was not an efficient hub with an optimal combination of waves of aircraft arrivals and departures. In 1992 the average connecting time for Air France passengers was 2 hours 48 minutes and early-1994 the airline offered an average of 16 possible connecting flights for each incoming flight compared with 23 for Lufthansa at Frankfurt and 29 for KLM at Amsterdam. Most internal French flights end at Paris-Orly airport, which is some 40 km away from Paris-CDG and the links between them are poor. This double handicap adversely affects the 'substitutability' of the Paris-CDG hub. Thus, the number of Air France transit passengers between EEA countries (other than France) and non-EEA countries would account for only approximately 4 % of the airline's traffic in 1991 and about 5 % in 1993. This means that the effect of the aid on feeder air traffic to the Paris-CDG hub may be considered very slight. Consequently, the position of the small airlines serving the Paris-CDG airport and the other major European hubs will hardly be affected.

- (33) With regard to the third point, it follows from what has been said previously about the restrictions imposed by bilateral agreements concerning designation that any limitation of capacity or price imposed on Air France on routes between France and non-member countries would basically benefit air carriers resident in the EEA in cases where the bilateral agreements allow some room for manoeuvre. On the market for transatlantic routes between France and the United States, where Air France has been in difficulty for several years as it is confronted by more powerful US airlines covering two thirds of this market in 1993, limiting

Air France's capacity would in fact directly benefit the airlines from across the Atlantic as the French authorities would not be able to impose the constraints incumbent on Air France to the same extent on the American airlines. Such a situation would be contrary to Community interest which calls for the development of the civil aviation sector in the Community.

- (34) Limiting, beyond the level of the bilateral agreements, the possibilities given to France to adapt its pricing or quantities available on intercontinental routes from France would furthermore hamper the airline's return to viability. Air France is one of the four Community airlines, with KLM, British Airways and Lufthansa, with an international network encompassing all parts of the world from its own country. The existence of this network and the 'Air France' trade mark are two of the principal assets of the airline which is faced with ever increasing competition from airlines of non-EEA countries, in particular on transatlantic routes.

III. CONCLUSION

- (35) All of the above meets the demand for a statement of reasons on the two points on which the 1994 Decision was found to be wanting because of insufficient reasoning. With regard to the other points, the Commission refers to the recitals of the text of the 1994 Decision that must be regarded as forming an integral part of this Decision without the need to repeat them here in full.
- (36) The Commission also notes that the annulment of the 1994 Decision removes the legal basis of the three decisions it adopted on 21 June 1995, 24 July 1996 and 16 April 1997 regarding the payment of the second and third tranches of aid to Air France. Under these conditions, it is proper not to object once again to the payment of the relevant tranches.

The Commission refers in this connection to the statement of grounds in the letters it sent to the French authorities on 5 July 1995⁽³¹⁾, 31 July 1996⁽³²⁾ and 10 June 1997⁽³³⁾, which must also be regarded as forming an integral part of this Decision,

HAS ADOPTED THIS DECISION:

Article 1

The aid granted to Air France by the French State in the period 1994 to 1996, in the form of a FRF 20 billion capital increase to be paid in three tranches, is compatible with the common market and the EEA Agreement by virtue of point (c) of Article 92(3) of the Treaty and point (c) of Article 61(3) of the Agreement, account being taken of the commitments and conditions of Articles 1 and 2 of Decision 94/653/EC, reproduced in Part I of this Decision.

Article 2

The Commission does not object to the payment of the second and third tranches of the capital increase of Air France effected in 1995 and 1996.

Article 3

This Decision is addressed to the French Republic.

Done at Brussels, 22 July 1998.

For the Commission

Neil KINNOCK

Member of the Commission

⁽³¹⁾ OJ C 295, 10. 11. 1995, p. 2.

⁽³²⁾ OJ C 374, 11. 12. 1996, p. 9.

⁽³³⁾ OJ C 374, 10. 12. 1997, p. 6 (incorporation of the FRF 1 billion previously blocked).