

# COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT BY THE COMMISSION TO THE COUNCIL  
AND THE EUROPEAN PARLIAMENT

on the evaluation of aid schemes established in favour of  
Community air carriers

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SUMMARY

1. The progressive development of the common aviation market has necessitated a comprehensive evaluation of aid measures established in favour of Community air carriers. Therefore, all Member States have been asked to update the available information on existing aids.
2. The Commission's services have carried out a careful assessment of the situation. This assessment has been based on the state aid rules of the Treaty and, in addition, on the evaluation criteria presented by the Commission in Annex IV of Memorandum N° 2 on the common air transport policy.
3. This report is given for information purposes only and does not preclude the results of any examinations the Commission will pursue on individual cases in accordance with Articles 92/93 of the Treaty.
4. The preliminary results of this work are that, as the information given by the Member States in a number of instances is presented in summarized form, it is not always possible for the Commission to arrive at definitive conclusions as to the compatibility of individual measures with the rules of the Treaty. On the basis of the additional information requested from the Member States concerned, the Commission intends to examine these cases in more detail.

The following table summarizes those cases which the Commission will pursue further, as well as cases on which the Commission has already decided according to Articles 92/93, and which request a certain follow-up.

	TYPE OF AID	REMARKS
BELGIUM	1. Aid programme for Sabena 2. possible subsidisation of Air Exel	ongoing examination (see Annex I) information is requested
DENMARK	granting of concession to SAS at Copenhagen airport duty free shop	a detailed report on the operation of the duty free shop is requested, including structure of the capital, financial figures over the last five years, a breakdown of the profits between shareholders and a description of the process by which the operators won their concession
GERMANY	1. preferential tax treatment: - tax deferral by deducting additional depreciation charges of the purchase value of aircraft (Art. 82F of the EStDV) 2. exemption granted to assets of transport companies providing public services (Art. 117 BwTG)	additional information is requested in particular about the criteria concerning this measure as well as an accurate breakdown for the different modes of transport concerned additional information is requested in particular about the precise applications of this measure
GREECE	1. possible subsidization of domestic or regional routes	information is requested and in particular a detailed breakdown of granted aids on a route by route basis including a description of the methods being applied for calculating the amount of aid, a definition of objectives to be achieved for each route, figures of traffic and a list of all existing competitors on the route

	<p>2. general guarantee to Olympic Airways borrowings (Articles 6 and 18(4) of law N° 96)</p> <p>3. possible capital increase and privatisation of Olympic Airways</p>	<p>additional information is requested, particularly on conditions and modalities of the guarantee granted to Olympic Airways borrowings as well as a list of the operations for which this guarantee has already been granted during the last five years</p> <p>Commission requested that the project be notified in accordance with the provisions of Article 93(3) of the Treaty</p>
<p>SPAIN</p>	<p>1. INI guarantee on export credits of the group Iberia</p> <p>2. capital increase of IBERIA</p>	<p>additional information is requested on the workings of the system, a detailed report on the operations realized by way of this facility and financial figures over the last three years</p> <p>The capital increase is being examined in accordance with Articles 92/93 of the Treaty</p>
<p>FRANCE</p>	<p>1. aids granted to regional air services</p> <p>2. general exoneration of all domestic flights from ATC charges</p> <p>3. loan guarantee scheme for Air France</p>	<p>additional information is requested and in particular for a precise breakdown on a route by route basis of the subsidized routes and companies, a list of all air carriers competing on these routes as well as accurate figures of passengers carried on these routes</p> <p>additional information is requested about phasing-out the system, its importance and a quantification of the financial advantages of this threatment</p> <p>confirmation requested that scheme is abolished</p>

	4. capital increase of Air France	evaluation of second part under way (see Annex II) according to the relevant articles of the Treaty
IRELAND	general guarantee granted to Aer Lingus borrowings by the State	additional information is requested about the modalities and conditions of the guarantee as well as a list of the operations for which the guarantee has already been granted
ITALY	aid scheme for domestic routes	additional information is requested for a precise breakdown of the subsidized routes and companies including figures of traffic and a list of all existing competitors on the routes
LUXEMBOURG	granting of concession to LUXAIR at Luxembourg airport duty free shop	a detailed report on the operation of the duty free shop is requested, including structure of the capital, financial figures over the last five years, a breakdown of the profits between shareholders and a description of the process by which the operators won their concession
NETHERLANDS	1. KLM's participation in Amst.-Schiphol duty free shop  2. support for KLM flight school	additional information is requested, including a detailed report on the financial results of the duty free shop during the last five years  ongoing investigation on basis of Art. 92/93 of the Treaty
PORTUGAL	1. general guarantee of the State to public companies (Decree law N° 260/76 and 29/84) and with regard to TAP	additional information is requested, particularly on updated information about the existence of the guarantee

	<p>2. sectoral taxation privileges to air transport concerning both direct and indirect taxation</p> <p>3. profits to TAP resulting from the operation of Lisbon Porto and Faro airports duty free shops</p> <p>4. possible capital increase of TAP Air Portugal</p>	<p>a detailed report on these privileges is requested</p> <p>a detailed report on the operation of these duty free shops is requested including structure of the capital, financial figures over the last three years, a breakdown of the profits between shareholders and a description of the process by which the operators received their concessions</p> <p>government has confirmed its intention to notify the measures according to Art. 93(3) EEC Treaty</p>
UNITED KINGDOM	direct operational aids granted to Scottish European Airways Ltd.	information is requested on the actual situation of the company and on the European destinations concerned

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I. INTRODUCTION

1. Development of a system of flag carriers after World War II

The Convention of Chicago of December 1944 confirmed the principle of national sovereignty. This principle gave rise to the exclusive intergovernmental bilateralism, for example the "Bermuda I" Convention and the network of agreements between companies. It stimulated the development of a system of flag carriers. Under this system, the states designate the companies, decide on the capacities and control the tariffs. State participation in the companies has been important or even exclusive, and regular subsidization by the state has been regarded as a normal practice.

In recent years, however, the bilateral system between Member States has been substantially altered by the development of the Community's competition policy and the liberalization of its aviation markets. The Commission's attitude towards state aids has to reflect these changes, as will be shown below, particularly as the liberalization process is now close to its decisive phase.

2. The liberalisation process

The Community is engaged in a widespread liberalisation policy which has considerably changed the European aviation landscape.

On December 14, 1987, the Council adopted the so-called "first package": new rules were introduced, for intra-Community scheduled services, on air fares and on sharing of passenger capacity and market access<sup>(1)</sup>.

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(1) Directive 87/601 on fares for scheduled air services, OJ N° L 374 of December 31, 1987, p. 12.

Decision 87/602 on the sharing of passenger capacity between air carriers on scheduled air services and on access for air carriers to scheduled intra-Community air services routes, OJ N° L 374, of December 31, 1987, p. 19.

On July 24, 1990, the Council adopted a second package of measures<sup>(2)</sup>. Access to third and fourth freedom services between all Community airports was permitted, with few exemptions, fifth freedom rights were extended to 50% of the capacity of the airline on the routes concerned and multiple designation was made easier. Member States were also allowed to increase their capacity shares for any season by 7.5 percentage points. Regulation N° 2343/90 also replaces directive 83/416 on regional air transportation.

On February 11, 1991<sup>(3)</sup> liberalization measures were also adopted for air cargo services.

The first two packages, however, did not contain rules on the relations between Member States and their own carriers nor on cabotage. The three new Commission's proposals of July 17, 1991<sup>(4)</sup> which constitute the third package, deal, inter alia, with these issues and in particular:

- define the technical and economic requirements which airlines must meet in order to obtain national licenses authorizing them to operate in the Community;
- provide for the free exercise of the freedoms of the air, including cabotage;
- abolish the sharing of passenger capacity;
- establish more liberalised rules on fares.

The adoption by the Council of these proposals will significantly modify the future of European civil aviation.

### 3. Competition policy

In parallel to the development of the liberalization policy, the related competition policy has followed important rulings of the Court of Justice. In 1974<sup>(5)</sup>, the Court decided that the general rules of the Treaty are applicable to air and sea transport and, in 1978<sup>(6)</sup> that state aids to the transport sector are submitted to the general rules of the Treaty. Following another important judgement<sup>(7)</sup> which emphasized the lack of application measures (pursuant to Article 87 of the Treaty) of competition rules to the aviation sector, the Council adopted, on December 14, 1987, together with the first package, two important regulations. Regulation 3975/87<sup>(8)</sup>, which entered into force on January 1, 1988, implements Articles 85 and 86 in the air transport sector.

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- (2) - Regulation 2342/90 of July 24, 1990 on fares for scheduled air services, OJ N° L 217, p. 1.  
- Regulation 2343/90 of July 24, 1990 on access for air carriers to scheduled intra-Community air services routes and on the sharing of passenger capacity between air carriers on scheduled air services between Member States, OJ N° L 217, p. 8.
- (3) Regulation 294/91, OJ N° L 36 of February 8, 1991, p. 1.
- (4) Document COM (91) 275 final, September 18, 1991.
- (5) Judgement of the Court of April 4, 1974, case 167/73.
- (6) Judgement of the Court of October 12, 1978, case 156/77.
- (7) Judgement of the Court of April 30, 1986, joint cases 209 to 213/84.
- (8) OJ N° L 374 of December 31, 1987, p. 1.



Regulation 3976/87<sup>(9)</sup> empowers the Commission to grant block exemptions to certain categories of agreements in the air transport sector.

The Commission has made use of its powers to grant block exemptions under Regulation 3976/87 by adopting, on July 26, 1989, the following three Regulations<sup>(10)</sup> which were modified on January 15, 1991<sup>(11)</sup>.

Regulation 4261/88<sup>(12)</sup> organizes the procedures on complaints, applications and hearings provided for in Regulation 3975/87. The Commission has also proposed to extend the scope of Regulation 3975/87 to domestic transport<sup>(13)</sup> and to transport between a Member State and a third country<sup>(14)</sup>. A similar extension was also proposed for regulation 3976/87<sup>(15)</sup>.

Fair competition is a key issue for the Community. In this respect a regulation empowers the Commission to take particular measures in order to prevent predatory behaviour<sup>(16)</sup> while a code of conduct for computer reservation systems (CRS) ensures unbiased competition and to some extent consumer protection<sup>(17)</sup>.

Finally, a regulation establishing common rules for the allocation of slots has been proposed with the purpose of ensuring transparency, non discrimination and a certain movement in the market<sup>(18)</sup>.

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(9) OJ N° L 374 of December 31, 1987, p. 9; modified by Regulation 2344/90, OJ N° L 217 of August 11, 1990, p. 15.

(10) Regulations 2671/88, 2672/88 and 2673/88, OJ N° L 239 of August 30, 1988, p. 9.

(11) Regulations 82/91, 83/91, 84/91, OJ N° L 10 of January 15, 1991, p. 7.

(12) OJ N° L 376 of December 31, 1988, p. 10.

(13) Document COM (91) 272 final of August 7, 1991, p. 8.

(14) Document COM (89) 417 final of September 29, 1989.

(15) - concerning domestic transport: doc. COM (91) 272 final of August 7, 1991, OJ N° C 225 of August 30, 1991, p.10.

- concerning transport between a Member State and a third country: doc. COM (91) 183 final of May 21, 1991, OJ N° C 153 of June 11, 1991, p. 21.

(16) Regulation 1284/91, OJ N° L 122 of May 17, 1991, p. 2.

(17) OJ NO L 220 of July 29, 1989, p. 1.

(18) OJ N° C 43 of February 19, 1991, p. 3.

4. Application of State aid provisions of the Treaty to the aviation sector

Since the Court has made clear, in its above-mentioned judgements of 1974 and 1978, that the general rules of the Treaty and, in particular, those concerning State aids, are applicable to air transport, the Commission has progressively investigated the relations between the Member States and their air carriers.

In its Memorandum N° 2 on the development of the Community air transport policy, the Commission established a set of guidelines and criteria for the evaluation of state aids in favour of air carriers on the basis of the EEC Treaty provisions on State aids laid down in Article 92/93(19).

The importance of a full and unrestricted application of the state aid rules of the EEC Treaty has been closely related to the degree of competition taking place in the relevant areas, in this instance the air transport sector. Though the traditional bilateral organisation of this industry did not exclude a certain degree of competition between air carriers, the potentially distortive effect of state aids has - in the past - been outweighed by economically more important rules on fares, market access and in particular capacity sharing which have been established restrictive bilateral air services agreements between Member States of the Community.

The above-mentioned measures in the area of market liberalization and competition already taken by the Council have fundamentally changed the economic environment for the air transport industry. They have, to some degree, reduced the discretionary powers of national authorities and extended the possibilities for air carriers to decide, on the basis of their own economic and financial considerations, fares, new routes and capacities to be put on the market. This shift of opportunities to take action, from public authorities to (public or private) enterprises will continue with the further development of the common aviation market.

In a more competitive environment state aids might be of substantially increased strategic importance for governments looking for measures to protect the economic interests of their "own" airlines. The common interest and the basic objectives of the liberalization process would, however, be at stake if such a subsidy race took place.

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(19) Document COM (84) 72 final, Annex IV.

5. Recent history: problems during and after the Gulf crisis

The Gulf hostilities produced a significant drop in the traffic and revenue of EC airlines. The fuel prices increased substantially, the costs for insurance, especially for services to and from the Middle-East, also went up, extra security measures occasioned higher costs and services had to be cancelled or re-routed.

Taking all these elements into consideration, the Commission expressed the opinion<sup>(20)</sup> that certain temporary measures were necessary, and in particular that the Commission was ready to examine favourably certain forms of state aids designated to compensate extra costs for security and insurance and to postpone the collection of parts of the charges concerning the control of air space.

However, the Commission recalled that other state aids remain within the guidelines developed in the Memorandum N°2.

In fact, the Commission has received no request concerning these facilities.

The Gulf crisis, as it is assessable at present, had a negative catalytic effect: all companies have seen a sharp fall in their 1991 profits; they have been forced to adapt themselves quickly and some of the weaker have disappeared. It must also be stressed that the restructuration process several carriers are engaged in, has suffered from the crisis. Moreover, 1991, particularly the second six months, was characterized by an almost frenetic search by some companies for partnership formulas, such as concentrations, mergers, or other forms of cooperation. Some flag carriers and some governments themselves were involved in this search.

6. The future of European aviation

State management, bilateralism and State interventions have protected the flag carriers in the past. However, the action of the Community which has increasingly liberalized the market and stimulated competition, as well as the consequences of the recession have transformed the former rules.

The flag carriers will have to adapt to their new European environment. They will have to develop a new understanding of their function in order to serve the regional European markets efficiently and to be able to compete on a global scale. Market dynamics will increase and more efficient and stronger airlines are needed to compete in both the European and global markets.

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(20) Document C(91) 422 final of March 5, 1991.

The Commission wants to create, as of 1993, a level playing field for competition but it acknowledges that some airlines carrying the financial burden of the past must have the chance for a fresh start provided that this does not adversely effect the situation of competitors. The Sabena case in 1991 is an example of how the Commission addresses such problems: it accepts that a far reaching reorganization programme was put in place with the help of a last and final set of State aids under strict conditions to be respected and under the permanent scrutiny of the Commission.

The Commission is well aware of the fact that other European carriers may be in need of a comparable programme in the near future.

As to State owned companies, the Commission will carefully examine whether planned capital increases are realised on the basis of the market economy investor principle, following the principles of the Treaty which remains neutral with regard to State ownership. The Commission acknowledges that state owned companies may have a justified need for additional own capital to realize an investment programme necessary to improve their efficiency and competitiveness. The first tranche of the capital increase of Air France in 1991 is an example of that. However, it should be clear that the Commission will not give any privileges to State owned carriers and that they will not have a guarantee for survival. In fact, one should be prepared to "think the unthinkable": namely that flag carriers might disappear from the market, either through mergers, or through bankruptcy when they prove unable to compete effectively.

The Commission will remain neutral in this process. It does not know what the "aviation landscape" will exactly look like in a few years time, nor does it want to determine in advance what should essentially be left to the market. The Commission's action will however be determined, on the basis of the principles of the Treaty, by the necessity:

- to offer to the consumer a developed intra-European aviation network with competitive pricing;
- to smooth the adaptation of air carriers to the common aviation market;
- to take account of conditions in the world market in which many European carriers compete;
- to integrate the aviation policy in the overall concept of European transport policy.

European aviation is in a phase of transition. The Commission is convinced that the finalisation of the liberalisation policy will lead to the dynamic and efficient air transport industry the European consumer has been looking for.

## II. EXISTING STATE AID MEASURES

Article 93(1) of the Treaty provides that the Commission shall keep all systems of existing aid under review and that it shall propose any appropriate measure required by the progressive development or by the functioning of the Common Market.

Under all the circumstances described above, a careful reconsideration of existing aid measures is required. Therefore, all Member States have been requested to up-date the available information on existing aid measures in favour of air carriers. This information provided by Member States was subject to a re-assessment with regard to the compatibility of existing measures with the state aid rules of the EEC Treaty in the light of the present situation.

In several cases which are assessed in the present report, the information provided by the Member States has been too succinct or not sufficiently detailed to permit the Commission a full assessment of the situation. Therefore, the Commission is obliged to request additional information and asks the Member States to respect the delays.

The Commission insists on the obligations of the Member States pursuant to Article 93(1) of the Treaty and the Directive 80/723 on the transparency of financial relations between Member States and public undertakings (as amended by Directive 85/413) to communicate all the requested information.

Under the strict limits of Article 93(1), the present Communication also mentions cases that are now being examined by the Commission. This examination is being carried out under the provisions of Article 93(2) and 93(3) of the Treaty and not under Article 93(1).

### The basic assessment criteria

The assessment criteria laid down in Annex IV of the Memorandum N° 2 are still applicable. They can be summarized as follows:

- the basic rule applying Articles 92/93 to the airline industry, imposes an obligation on Member States to notify the Commission pursuant to Article 93(3) of the Treaty any plan to grant or to alter state aids; all aid measures which distort or threaten to distort competition are in principle incompatible with the common market (Article 92(1) EEC Treaty);
- a further basic principle of the state aid rules of the EEC Treaty is that exemptions may be given only on the basis of common interest considerations. To cover an airline's operating loss by state aids would not be considered as being compatible with the common market. However, in those cases where real possibilities for improvement exist the Commission could authorize aids if they are an integral part of a programme for restoring its financial viability and competitiveness of an airline;

- the Commission is currently favorably disposed to accept aids aimed at supporting the operation of domestic routes. However, if this type of aid would have the effect of diverting significant volumes of international traffic into the Member State in question or allow carriers to cross-subsidize international operations, they would be considered as incompatible with the common market;
- with regard to public service obligations, compensation for the performance of the obligation to operate a particular route may be compatible with Article 92(1) on the grounds of not affecting trade between Member States, or under Article 92(3) as promoting regional development. However, an exemption for intra-Community routes would depend on the likely distortion of competition, the resulting effects on trade between Member States, and on the fact that no other airline would be willing to provide the required level of service without receiving aid;
- the provision of capital, loans or guarantees by public institutions to an airline may constitute either an aid or a normal commercial transaction between the owner of an air carrier and that company. In order to assess specific cases it would in be necessary to evaluate whether a private investor under comparable conditions would have taken a similar decision (market economy investor principle);
- the Commission does not intend, for the time being, to take action against a general exemption of aviation fuel from taxation and air services and related to activities from VAT since the relevant rules of the Community concerning VAT are still not in force.

The proposals of the third package which are now being discussed in the Council will liberalize cabotage within the Member States. The situation will consequently be substantially modified and the Commission will have to adapt its current position on this subject.

Indirect taxes will not be examined until the Community has - in the framework of the harmonisation of indirect taxes - adopted compulsory rules pursuant to the political agreement reached by the Council on June 24, 1991.

The harmonisation of airport charges related to domestic and international flights is being examined by the Commission in the framework of the proposed regulation on consultation between airport and airport users and charging principles. The Commission is now assessing the results of this examination and requesting additional information from some Member States. Airport fees are therefore not treated in this report. The Commission will communicate at a later stage the further steps it plans to take in this area.

1. BELGIUM

1.1 Description

A. DIRECT OPERATIONAL AIDS

At present, no direct operational aids, supporting specific routes, are given. In 1986 the last aid (BF 4,000,000) was granted to support certain regional routes.

B. POTENTIAL FINANCIAL AIDS

(1) The Belgian State has a 54,72% holding in SABENA.

The financial situation is difficult: following the airline's operating losses of 1989 and 1990 (respectively BF 1.25 billion and BF 7.5 billion), cumulated losses reached BF 42.2 billion in 1991 (rising from BF 17 billion in 1984).

The dividend was determined in the Statutes and guaranteed by law: since 1984, the global statutory dividend reached BF 437,500,000. The same mechanism granted yearly a guaranteed BF 33,750,000 dividend to the State. This appears to be rather low.

Subsidies for interest charges were paid to SABENA, the national flag carrier, until the end of 1987. In accordance with the earlier version of Article 10 of SABENA's statutes, all financial obligations resulting from loans (interest charges, amortization) were automatically guaranteed by the Government. With effect from 1 January 1985, the Government's legal support for SABENA's interest charges under to Article 10 of the statutes was abolished. The aid was continued for SABENA's loans arranged prior to that date. However, the Government decided to terminate this aid by the end of 1988.

Accordingly, the following amounts were paid from 1985 to 1988:

1985: BF 357,250,824  
1986: BF 298,640,790  
1987: BF 244,785,433  
1988: BF 0.

From 1985, the intervention of the Belgian state, based on Article 10 of SABENA's statutes, was transformed from legal commitments to intervene into a discretionary power of the Government to grant the guarantee of the state to SABENA's borrowings on a case by case decision.

SABENA undertook a long restructuration process, which is not yet terminated. A tripartite shareholding and co-operation agreement between British Airways, KLM and SABENA ran for a year between January 1990 and 1991. It was aimed at providing SABENA with foreign investments: the new joint venture "Sabena World Airways" which took over the flight activities of SABENA, benefited from provisions of BF 2 billions of each foreign partner (KLM and British Airways) and of BF 6 billion from the SABENA holding company. The Commission objected to this agreement on the basis of Articles 85 and 86 of the Treaty. Following the decision of BA, KLM and SABENA, on 1 January 1991, to abandon their joint venture, SABENA announced in February 1991 a new restructuration plan covering the period 1991-1995 which was backed by the Belgian Government on March 22, 1991.

This restructuration plan was notified (state aid C.21.91 ex. N° 204/91) to the Commission which decided on July 24, 1991 (1) to consider the state aids as compatible with the common market in the sense of Article 92(3c) of the EEC Treaty on condition that the Belgian Government commits itself:

- to abstain from granting any further aids or any new measure favouring Sabena;
- not to grant any privileged treatment to Sabena, in comparison to other Belgian or Community air carriers;
- to transfer privileged shares into normal risk shares;
- to adopt new company statutes based on private commercial law;
- to inform the Commission of the performances and strategic decisions concerning Sabena.

The second stage of the restructuring plan of SABENA which involves the conclusion of a cooperation agreement with a foreign investor is closely followed by the Commission. In this framework, a BF 3 billion transitory credit has been granted by the Belgian authorities to compensate the absence of governmental approval to the Sabena-Air France agreement due to the political crisis in Belgium.

Because of its general interest, this case is described in more detail in Annex 1 to this report.

- (2) At the end of 1991, the Commission received information on possible state aids to the regional carrier Air Exel. The Commission is aware of Air Exel's bankruptcy in January 1992.

#### C. OTHER

##### Taxation

In the area of direct taxation, Sabena, like other Belgian companies, does not benefit from any privileges.



With regard to indirect taxes (VAT and fuel taxes), the usual international exemptions are applied to international flights.

## 1.2 Assessment

The Commission has decided to consider the intervention of the state into SABENA's restructuring plan as compatible with the common market in the sense of Article 92(3c) of the Treaty on the conditions mentioned above. Subsequently, the Commission has received informations from the Belgian authorities about the implementation of this restructuration process. The Commission is currently examining the transitory credit of BF 3 billion granted by the Belgian authorities to SABENA. More details on this case are given in Annex I.

The Commission requested information about the possible subsidization of Air Exel.

The Commission will pursue these two cases with the Belgian Government.

2. DENMARK

2.1 Description

A. DIRECT OPERATIONAL AIDS

According to information presented by the Danish Government, no direct aid is granted in favour of Danish air carriers.

B. POTENTIAL FINANCIAL AID

Public shareholding in the Company SAS is 50%. This percentage has remained stable since 1951.

With regard to dividend payments, public and private shareholders are treated equally.

No state guarantees aimed at supporting SAS' borrowing have been established over recent years.

C. OTHER

With regard to taxation, no special privileges in favour of SAS are given either in Denmark or in the other Scandinavian countries (Norway, Sweden).

SAS is not subject to tax. The parent company in each country is taxed by its authorities under normal taxation law for its share of SAS profit.

However, the Commission is concerned about the arrangements for operating the Copenhagen airport duty free shop. Some indications suggest that SAS could benefit from privileges arising from the operation of the duty free shop.

2.2 Assessment

Since no direct aid is given, no observation needs to be made.

The Commission estimates that the arrangement for operating the Copenhagen airport duty free shop and, in particular, the role of SAS in this business, require a detailed examination. The Commission will pursue this case further.

### 3. GERMANY

#### 3.1 Description

##### A. DIRECT OPERATIONAL AIDS

- (1) Direct operational aids are granted by regional authorities to support specific domestic routes.

The routes include:

- Hof-Bayreuth-Frankfurt/M:  
1.919 million DM ("MDM") in 1990 (1.388 MDM in 1988) are jointly granted by the Land Bayern, the towns of Hof and Bayreuth and the Landkreis (region) of Hof, Bayreuth and Wunsiedel to Nürnberger Flugdienst (Nürnberg);
- Saarbrücken-München v.v.; - Hamburg v.v.:  
1.500 MDM are granted by the Land Saarland to Nürnberger Flugdienst (Nürnberg) and Saarbrücken-Frankfurt v.v.;;  
1400 MDM are granted by the Land Saarland to DLT mbH (Kriftel);
- The aid granted by the Land Baden-Württemberg to Delta Air Friedrichshafen for operating the route Stuttgart-Friedrichshafen (500,000 DM in 1986) was progressively decreased until 1990 by portions amounting to 100,000 DM a year. This implies the cancellation of the aid from 1991. An aid by the Land Saarland of 1.95 MDM to DLT for operation of the route Saarbrücken-Düsseldorf-Frankfurt/M was cancelled in 1989.

All these aids are aimed at covering trading losses.

- (2) Furthermore, on 26.9.1990 the Commission approved an investment aid of approx. 15.5 MECU in favour of the air carrier Lufthansa aimed at promoting a substantial extension of the capacities of Lufthansa's pilot school which located at Bremen airport. This aid was part of a special regional development programme for the labour market in the region of Bremen. The aid measure is in line with the modalities of this programme as approved by the Commission in 1984 and 1990. The investments should contribute to create jobs and to overcome the current shortage of pilots licences for big commercial airplanes.

##### B. POTENTIAL FINANCIAL AIDS

The German State has a 51.42% stake in the capital of Deutsche Lufthansa (September 1991) (if one adds other public institutions whose shares amount to 3.30%, the total influence of the public sector represents 54.72%). No particular financial assistance from the state in favour of the company has been noted over recent years.

The following dividends have been paid to shareholders since 1985:

Year of payment	M D M	% of the nominal value of a share	profits of the year
1985	81	7	1984
1986	63	7	1985
1987	63	7+2%bonus	1986
1988	84	7	1987
1989	96.5	8	1988
1990	121.6	8	1989
1991	6.65 (proposed by the Annual General Meeting)	5 (only on preference share without right to vote)	1990

It has to be noted that the German State has no preference shares.

Deutsche Lufthansa has a 52% holding in the regional operator DLT.

C. OTHERS

(1) The Federal Government grants exemption from fuel taxes and VAT on all scheduled air services (international and domestic).

(2) Preferential tax treatment does exist in two areas:

a) in accordance with Article 82f of the Income Tax Implementing Order (Einkommensteuereinführungsverordnung), German air carriers can claim a tax deferral by deducting, in addition to the "normal" depreciation, charges of 30% of the purchase value of aircraft during the first four years following the purchase, provided that the aircraft is not sold within a period of six years after the purchase. This preferential tax treatment which also applies in a slightly modified form for maritime transport provides - according to estimates by the German authorities - a total annual tax relief of approximately 100 MDM for both areas (air and maritime transport). This measure, which was introduced in 1965, is, according to the German authorities, due to terminate on December 31, 1994,

b) the second tax exoneration refers to capital tax (Vermögenssteuer). According to Article 117 of the Valuation Tax Law (Bewertungsgesetz) which establishes the rules for calculating the tax value of the assets of transport companies, all assets used for public service activities are exempted from inclusion in the capital tax bill.

### 3.2 Assessment

- Apart from the Bremen school case, direct operational aids in favour of German air carriers are given exclusively by regional authorities in favour of operations on certain domestic routes.

According to the criteria laid down in the Annex IV of the Memorandum N° 2 on civil aviation, such aids would be incompatible with the Common Market only if they had the effect of diverting significant volumes of international traffic into the Member State in question or of allowing carriers to cross-subsidize their international operations. The present circumstances indicate that such criteria do not apply to the four above-mentioned cases.

- Regarding the aid granted in favour of the Lufthansa Pilot School at Bremen, no additional observations need to be made about the implementation of the aid.
- The tax relief in favour of air transport requires careful analysis. In particular, the possibilities of a tax deferral, by deducting additional depreciation charges has - in the case of fluctuating profits - a positive impact on the net profits of an air carrier. The preferential treatment in favour of the air transport industry improves the ability of an airline to invest in new equipment. It has, therefore, a direct impact on competition to the detriment of competitors from other Member States. Before formulating an opinion about the conformity of this measure with Articles 92/93 of the Treaty, the Commission's services would like to have more information as well as an accurate breakdown for the different modes of transport concerned.

The second tax privilege in favour of air carriers carrying out public services (i.e. Lufthansa) is based on exemptions on assets used for public services when calculating the total value of assets for capital tax purposes. According to the legal basis only assets directly used for public service activities may benefit from this exoneration (Article 117 of the "Bewertungsgesetz").

On the basis of the information available the net financial effect of this measure is difficult to assess. No information exists on which activities of the national flag carrier, Lufthansa, are used for which public service activities. According to the German authorities it is not possible to calculate the budget value of this measure. It appears possible, however, that Lufthansa is making use of this provision in order to reduce the total costs of its capital. In this case the Commission would have to intervene on the basis of Article 92/93 of the EEC-Treaty.

The Commission will pursue these two cases with the German Government.

4. GREECE

4.1 Description

A. DIRECT OPERATIONAL AIDS

According to the Greek authorities, no direct operational aids are granted.

However, the Commission is aware that, for social and political reasons, Olympic Airways flies over 30 domestic destinations, including 20 islands. These operations accounts for most of Olympic's deficit.

B. POTENTIAL FINANCIAL AID

Olympic Airways has been wholly state owned since 1975.

As a consequence of the high interest payments paid by Olympic Airways, particularly since 1980 (DR 14bn in 1986, DR 16bn in 1987, DR 18bn in 1988), the company's final results have been negative :

minus DR 19.8 bn in 1986  
minus DR 7.6 bn in 1987 and  
minus DR 8 bn in 1988.

In 1989, the net annual operating result, before taxation was DR 24 bn; the cumulative loss up to 1989 was DR 111.17 bn and the total support to the company for 1989 was DR 39 bn. The airline losses for 1990 are expected to reach DR 20 bn.

The above mentioned losses have been financed by interest bearing loans from government-controlled banks and state enterprises rather than direct State aids. As a result, annual interest charges have risen sharply and the debt-capital ratio is extremely poor.

Two important elements are to be found in the Greek law n° 96 of 26 June 1975 which governs Olympic Airways' status under state control.

Article 6 of this law states that : "Olympic Airways which since it was founded has been a public utility company, is hereby permitted to contract loans at home or abroad, the State being at liberty to provide whatever guarantees, adjustment and repayment by Olympic Airways of such loans and of any credits, generally speaking, of whatever kind".

Article 18 paragraph 4 of the same law exempts Olympic Airways from the obligation to pay any tax or duty or interest duty stamps in respect of interest for foreign loans or credits payable either in Greece or abroad.

Taking account of the large interest payments mentioned above the Greek Government appears to have made extensive use of this possibility to grant guarantees while arguing that the guarantee represented a normal commercial transaction and that "the Greek State was flexible about Olympic Airways' respect for deadline payments".

Following Olympic Airways' difficulties, the Greek Government plans to restructure and to privatize the Company. This will take place in the framework of a large privatisation plan - covering 208 enterprises - which was assessed by the Commission in July 1991. The Commission has decided to treat the case of Olympic Airways individually and to require an obligatory notification to the Commission of all projects of State aid taking place in the process of privatisation.

On 23 July 1991, the Commission reminded the Greek authorities of their obligation pursuant to Article 93(3) of the Treaty in the specific case of Olympic Airways privatisation.

C. OTHER

Article 14 of Decree 3560/56 which governs the relationship between the public sector and Olympic Airways, was used to exempt Olympic Airways from paying airport and air navigation fees and granted the company free use of space on national airports in accordance with its needs.

These exemptions and facilities were used to compensate services provided by Olympic-Airways to the public sector (transport of civil servants, low frequency routes organized at the request of the public sector,...).

Strong reactions of other Member States carriers led the Greek authorities to modify Decree 3560/56. Pursuant to this new regulation, both Olympic Airways and foreign air carriers' international flights are subject to the same airport and navigation fees.

According to the Greek authorities, air traffic control fees related to Olympic Airways' domestic operations have been collected by Eurocontrol since 1 January 1989 (Decision of 30 August 1988).

In accordance with the 1990 Commission Proposal on consultation between airports and airport users and on charging principles, the Commission has requested the Member States to provide information on the alignment of airport charges for domestic and intra-Community air services. The Commission is now assessing the results of this study - or requesting additional information of some Member States - and will communicate in due time the steps it plans to take following the results of this study.

With regard to the utilisation and the granting of space on national airports, the Greek authorities have assured the Commission that following the modification of article 14 of Decree 3560/55, Olympic Airways now builds at its own expense on the territory of national airports and that foreign companies are subject to the same condition.

#### D. Recent financial results

Apart from the Olympic Airways situation, the Greek authorities did not provide any figures on other airlines.

#### 4.2 Assessment

- . The Commission is concerned about possible public support to domestic air services. The Commission usually accepts subsidization of domestic routes aimed at compensating public services obligations and this is particularly the case for remote islands whose inhabitants rely on air services.

However, each case must be assessed by the Commission in order to verify if they do not contribute to divert significant volumes of international traffic or would allow carriers to cross-subsidize international routes on which they compete with carriers from other Member States. To make this assessment the Commission needs to have more detailed information.

- . The poor financial performance of "Olympic Airways" and its cumulated deficit could suggest that the extensive use of State guarantees for the Company's borrowings is basically aimed at continuing the operations of a company which is not viable if normal commercial considerations are applied. Furthermore the analysis of Articles 6 and 18 (4) of Law n° 96 of 26 June 1975 demonstrates the existence of general and unspecified guarantees which appear not to be justified by common interest or public service considerations. In its Memorandum N° 2 on aviation, the Commission has insisted on these criteria and on its wish to see the guarantees being notified.

However, the Commission does not have any accurate data about the amounts that were guaranteed as well as the modalities and conditions of the guarantees.



- . With regard to Olympic Airways' possible privatisation, the Greek authorities are aware that any state aid which will be granted has to be notified to the Commission for examination under the relevant articles of the Treaty.
- . The Commission needs more information concerning Olympic Airways' financial results and figures related to its deficit as well as concerning its subsidiaries.
- . As to the harmonization of airport charges between domestic and international flights, the Commission will communicate in due time, after assessment of the above mentioned study, the steps it plans to take. The Commission notes in the meantime that Decree 3560/56 ensures similar airport and navigation fees to Olympic Airways and foreign air carriers' international flights.

It also takes note of Eurocontrol's involvement in the collection of ATC charges for Olympic Airways' domestic operations.

- . The Commission will pursue these questions with the Greek Government.

5. SPAIN

5.1 Description

A. DIRECT OPERATIONAL AIDS

- (1) According to the information communicated by the Spanish Government, aids are granted by the Spanish authorities to reduce air fares between the Mainland and the Canary Islands, Melilla and the Balearic Islands.

This aid is based on Law 33/1987 of 23 December 1987 and on Royal Decree 255/1989 of 17 February 1989. It is paid from the State's general budget which stipulates that citizens of Spain and all other EC Member States who are residents in the Canary Islands or Melilla qualify for a 33% reduction on air (and ship) fares. Residents of the Balearic Islands qualify for a 25% reduction. Flights between Canarias islands or between Balearic Islands qualify for a 10% reduction in similar conditions.

These reductions are granted directly by the airlines upon presentation of residence papers.

The airlines then submit, each quarter, the exact amounts to the responsible authorities which are paid from the relevant budget.

These consumer-oriented aids are in fact considered as compensating public services obligations.

The following amounts have been or will be paid :

(billion pesetas)

	1988	1990	1991	1992
Canary Islands	3.1	4.32	4.25	8.2
Balearic Islands	0.9	1.2	1.19	2.6
Melilla	0.1	0.1	0.1	0.5

- (2) A specific vocational training programme is aid-granted under a general aid scheme approved by the Community.

B. POTENTIAL FINANCIAL AID

- (1) Equity :

a) Iberia is owned by the State (99,82% since 1987) via INI, the National Institute for Industry.

Between 1979 and 1985, Iberia accumulated losses totalling 84.1 bil. pts. This development led to a serious financial disequilibrium with debt/capital ratios reaching 100/9. Under these circumstances, capital injections were necessary to avoid bankruptcy and to comply with national laws on public limited companies which, in Spain, stipulate that companies must re-establish their capital.

Consequently, during the period from 1984 to 1986, a capital injection of 55 bil. pts was made, of which 10 bil. pts in 1986, the first year of Spain's EC membership.

The capital increased from 68.2 bil. pts in 1984 to 93.2 bil. pts in 1987 and has remained stable ever since.

These measures have been accompanied by a restructuration programme aimed at re-establishing a sound financial basis for the continuation of the operations.

As a result, Iberia returned to profit in 1986 (0.87 bil. pts), in 1987 (20.5 bil. pts), in 1988 (24.2 bil. pts) and in 1989 (6.2 bil. pts), and in 1988 paid its first dividend (6.5 bil. pts) for ten years.

However, Iberia suffered heavy losses again in 1990 (-24.3 bil. pts) and is expecting losses between 30 and 45 bil. pts for 1991. The Spanish authorities notified on 18 February 1992 a wide restructuration programme including a capital increase of 120 bil. pts. Consequently, the capital would amount to 213 bil. pts.

- b) The air carrier "Spantax" was the largest charter carrier established in Spain. Following a number of years during which the company faced financial difficulties, "Spantax" was finally declared bankrupt on 6 April 1988.

Following this declaration, the creditors consortium, in which public authorities played an important role, decided to take joint action through measures aimed at recovering the existing debts.

The question of public guarantees arose and serious consideration was given to re-establish the carrier.

Following a request from the Commission, the Spanish authorities confirmed that an aid package containing debt deferment, repayment extension for social security debts and particular social provisions had been seriously considered during the bankruptcy procedure.

The Spanish Government argued that all these arrangements were based on national legislation for bankruptcy procedure and didn't represent, therefore, a specific aid measure.

Taking into account that all attempts to re-establish the operations of Spantax finally failed and that the company ceased all forms of operations, the Commission has, after a detailed examination, decided not to initiate any measures in this case.

(2) Borrowing:

Spanish air carriers can borrow on the open market. Airlines borrowing are not backed by the State guarantee except for export credits obtained by Iberia or by Iberia's aviation subsidiaries.

In this case, when a foreign country requires the guarantee, the INI (and not the other shareholders) is authorized to guarantee the credit.

C. OTHER

All air carriers operating domestic flights in Spain (even if not Spanish) pay reduced landing charges by comparison with international flights.

In accordance with the 1990 Commission proposal on consultation between airports and airport users and on charging principles, the Commission has requested the Member States to provide information on the alignment of airport charges for domestic and intra-Community air services.

The Commission is now assessing the results of this study - or requesting additional information to some Member States - and it will communicate in due time the steps it plans to take following the results of this study.

D. RECENT FINANCIAL PERFORMANCE

(1) Iberia's results have been described above.

(2) Aviaco is 32,9% owned by Iberia and almost all the remaining shares are held by INI which is the main shareholder of Iberia.

The carrier made profits and paid regular dividends.

(bil. pts)

	results	dividend
1987	1.6	-
1988	3.0	0.5
1989	2.2	0.6
1990	3.5	0.7

5.2 Assessment

The aids to support air traffic between the mainland and the peripheral region are strictly related to fare reductions and do not include, therefore, direct aid elements improving the financial situation of the air carriers concerned. The payment is made to the carrier for technical reasons. In fact, the air carriers are, by granting reductions upon presentation of residence papers, disbursing the relevant amounts until receiving the compensation from the public budget. This system guarantees absence of cross-subsidization. Furthermore,

the decision of the Spanish authorities to grant consumer aids for flights to peripheral regions is based on public service and regional policy considerations. Since all Community citizens being residents of the regions concerned are treated equally, no discrimination occurs.

- . As to the specific vocational training programme assisted under a general scheme approved by the Community, no additional remarks are required.
- . With regard to Iberia's financial situation, the Commission notes that from 1986 to 1989, following its restructuration plan, Iberia made a major turnaround from close to bankruptcy to a profitable European carrier. In the meantime, Iberia has drafted a new restructuration plan. This plan, including the capital increase, was notified to the Commission on 18 February and is currently being examined in accordance to Articles 92/93 of the Treaty.
- . The evolution of the Spantax case has led the Commission not to initiate measures following the impossibility for the creditors consortium to reach an agreement to re-establish the air carrier.
- . Regarding the INI guarantee covering exportation credits of Iberia and its subsidiaries, the Commission, due to the lack of information, needs more information to carry out an evaluation of this facility.
- . On the harmonization of airport charges between domestic and international flights, the Commission will communicate in due time, after assessment of the above mentioned general enquiry, the further steps it plans to take.
- . The 65% reduction granted to Spanish air carriers for handling facilities is currently being assessed by the Commission pursuant to the appropriate provisions of the Treaty. Consequently no additional observations will be made about this case.
- . The Commission will pursue these questions with the Spanish Government.

6. FRANCE

6.1 Description

A. DIRECT OPERATIONAL AIDS

- (1) Direct operational aids to support air services on particular routes have been granted for
- a. air services between Corsica and the mainland
  - b. other regional air services.

During the recent years the following amounts have been paid:

a. Corsica (millions francs)

	1985	1986	1987	1988	1989	1990*
Air France	51.3	52.6	58.2	56.6	51	35.1
Air Inter	32.3	31.0	27.1	30.7	34.9	36.4
TAT	-	-	9.0	8.3	9.1	12.9
Air Corse	-	-	0.9	2.8	3.0	-
Kyrnair	-	-	-	-	-	1.9
CCM	-	-	-	-	-	20.4

\* provisional figures

These aids compensate part of the trading losses of companies providing air services of public interest between Corsica and the French mediterranean littoral. The CCM (Compagnie Aérienne Corse Méditerranée) was also granted 50 MF of equipment subsidies in 1990.

Following the agreement between Air France, the French authorities and the Commission, which settles the case of the "Air France, UTA, Air Inter merger", the French authorities have opened the Paris-Ajaccio and Paris-Bastia routes to competition from domestic airlines. However, to date no other carrier has wished to compete with Air France on the two routes.

b. Other regional air services

Certain regional air services are supported, to some extent, mainly by regional authorities. In 1988, a total sum of 58 million francs was paid. This represents approximately 3% of the total turnover of the companies operating such services. 25 MF of the 58 MF was paid to Air France.

In 1989, this grant was increased to 86.9 MF (31 MF to Air France) and in 1990 the grant reached 117.5 MF (59.7 MF to Air France).

Further detail on these aids, which is necessary for an accurate assessment, has not been communicated by the French authorities to the Commission.

It should be mentioned that air services to overseas departments (DOM services) have not been granted aid since 1984.

(2) Aids for the operation of particular aircraft types

Another type of direct operational aid was given for the operation of certain aircraft types. However, it has to be noted that these aids were stopped in 1987 (Concorde) and 1990 (Mercure) respectively.

<u>Concorde:</u>	grant to Air France	(MF)
1985 :	76.2	
1986 :	50.1	
1987 :	0	
1988 :	0	
1989 :	0	
1990 :	0	

<u>Mercure :</u>	grant to Air Inter	(MF)
1985 :	2.1	
1986 :	2.3	
1987 :	0.4	
1988 :	0.4	
1989 :	0.428	
1990 :	0	

The grant provided to Air Inter covered the overrun of spare parts and the necessary modification works.

B. FINANCIAL AID

(1) Equity contributions

Until January 12, 1990, the French air sector was divided into four components:

- Air France: owned 99% by the State (the French State contributed capital stock reaching 200 millions francs in 1984 and 150 MF in 1985);
- Air Inter: although the State and the regional authorities had no direct participation in the stock of Air Inter, 57% of the capital belonged to the public sector;
- UTA was privately-owned;

- Regional companies: some companies were partly owned by regional authorities. Furthermore, Air France itself has a substantial stake in these regional companies, namely TAT, Aéro-maritime and Air Charter.

The newly created "Groupe Air France" (January 12, 1990), resulting from the merger with Air Inter and UTA, is 98,5% owned by the State.

The merger was subject to an agreement (of 30 October 1990) between the Commission, the French Government and Air France by which the Commission set conditions for its approval of the conformity of the merger with the competition rules of the Community.

The agreement provides for, among other measures, the progressive withdrawal of the participation of Air France in TAT (maximum 15% stake by June 30, 1991, and no representative on the board), Aéro-maritime and Air Charter, as well as the opening up of certain interregional routes to competition.

Moreover, the companies of the Groupe Air France have committed themselves for the next four years, not to take any participation in the capital of an air transporter established in France.

The merger itself took place without any financial intervention of the State. However, capital will be injected as part of a plan aimed at improving the capital base of the company by a total of 5 billion FF over the next three years. On November 20, 1991, the Commission decided that the first capital increase amounting to 2 billion FF is to be considered as a normal financial transaction and, consequently, not as state aid. However, the Commission explicitly reserves its position regarding a further increase of Air France's capital envisaged for 1992 and 1993. The second financial contribution, namely a 1.25 bn F capital injection by the Banque National de Paris BNP, is now being examined by the Commission.

Even though the case is not state aid, this specific application of Art. 92/93 is described, because of its general interest, in more detail in Annex II to this report.

## (2) Guarantees

The French State does not provide any guarantees to covering losses.

## (3) Loans

Airline companies do not benefit from state loans. However, Air France could have its loans guaranteed by the State but this has not happened since 1977.



C. OTHERS

- (1) In the area of ATC charges, a preferential treatment for domestic flights is applied in France. In fact no ATC charges have to be paid for these services. However, no information has been given by the French government neither concerning the amount (approx. 300 million FF in 1988) of the general exoneration from ATC charges, nor concerning the dismantling of this potential aid which was planned to be carried out from 1990 to 1992.
- (2) There is no preferential treatment for air carriers established in France regarding direct taxation.
- (3) In the field of indirect taxes, exemptions from VAT on fuel are, in accordance with international practice, granted for international flights and also for services between the mainland and Corsica.

D. RECENT FINANCIAL PERFORMANCES

Groupe Air France

1988:	. net consolidated profit:	1,152	MF
	. distributed dividend :	299	MF
1989:	. net consolidated profit:	841.3	MF
	. distributed dividend :	280	MF
1990:	. net consolidated loss:	-717.2	MF
	. distributed dividend :	20	MF

6.2 Assessment

- . The operation of domestic routes, has to be examined, pursuant to the criteria laid down in the Memorandum N° 2, as to whether or not these aids could contribute to divert significant volumes of international traffic into the Member State in question or could allow air carriers to cross-subsidize their international operations. There is no evidence that this occurs in the case of air services to Corsica. Furthermore, the French authorities have indicated that these aids are granted to compensate for public service obligations on the routes between Corsica and the mainland. In this case, the circumstances demonstrate compatibility with Article 92.1 (not affecting trade between Member States) and with Article 92.3(a) (promotion of regional development).
- . With regard to regional air services other than those with Corsica, the information provided to the Commission does not permit an accurate assessment. The term "regional air services" used by the French authorities suggests that in contrast to the Corsica services, the regional services do concern intra-Community routes. In this case, according to criteria laid down in Memorandum N° 2 (distortion of

competition and effect on trade between Member States which could result from the subsidisation of regional intra-Community flights), it is unlikely that the Commission would exempt such aid except if no other airlines were willing to provide the required level of service on the route without receiving aid or in the circumstances described at Article 5(3) of Regulation 2343/90 (public service).

However, if some of the "regional" routes are in fact domestic, the criteria used in the examination of the services to Corsica would be relevant.

Therefore, a precise breakdown of the subsidized routes and companies, a list of all air carriers competing on these routes as well as accurate figures on passengers carried on these routes at present and, if possible, in the future should be requested from the French authorities.

- . The Commission recalls that it reserves its position on the increases of Air France's capital to be carried out in 1992 and 1993 subsequent to the decision related to the 1991' capital increase. The examination of these further steps will take place under the Articles of the Treaty regarding state aids.
- . Regarding the general exoneration of all domestic flights from ATC charges, the French authorities are asked to give details of the phasing-out system to be carried out from 1990 to 1992, as well as quantify in financial terms the importance of this preferential treatment.
- . The Commission notes that aids for the operation of certain aircraft types (Concorde, Mercure) have been abolished.
- . With regard to the possibility to guarantee the borrowing of Air France, which according to information from the French Government has not been used since 1977, it would be helpful to clarify whether the scheme has been definitely abolished.
- . The Commission will pursue these questions with the French Government.

7. IRELAND

7.1 Description

A. DIRECT OPERATIONAL AIDS

Since 1986, no direct operational aid has been granted to Irish air carriers.

B. POTENTIAL OPERATIONAL AIDS

Aer Lingus is still wholly state owned (100%). The airline is required to act in a commercial manner and to provide a return on its investment. No equity has been invested by the State in the airline since 1984 and there has been no write-off of equity capital.

The following dividends have been paid:

- 1987/88: 2.182 m IR£
- 1988/89: 2.52 m IR£
- 1989/90: 2.52 m IR£
- 1990/91: 0.5 m IR£.

The State does not provide a guarantee for airline losses. The limit of the guarantee granted to Aer Lingus borrowings by the Irish State has remained stable at 150 m IR£, an amount that was already granted in 1988.

Accordingly, 41.2 m IR£ has been guaranteed by the State on March 31, 1991.

It is noted that the actual replacement of Aer Lingus' European and commuter fleet, at a cost of US\$ 602 m, is currently being undertaken without any State equity or guarantee of borrowing.

C. OTHERS

As regards taxation, no preferential tax treatment or other form of aids have been granted.

D. RECENT FINANCIAL PERFORMANCES

Aer Lingus' performance since 1987 has been as follows:

Net profit before tax:	1987/88	37.8 m IR£
	1988/89	39.7 m IR£
	1989/90	38.7 m IR£
	1990/91	6.2 m IR£.

The company has been under pressure in the past year due to recession in the U.K. and U.S. markets and the Gulf crisis. Aer Lingus is implementing a recovery programme and completing the replacement of its European and commuter fleet.

## 7.2 Assessment

- . No direct operational aids are granted to Irish carriers.
- . In the area of the financial relations between the State and the wholly State owned company Aer Lingus, existing guarantees require careful examination. Although the Irish State emphasizes its will to progressively reduce the amount of State guaranteed borrowing to this company, the amount of 150 m IRF (maximum potential limit of the guarantee) has remained stable since 1988. On March 31, 1991, 42.2 m IRF was effectively guaranteed by the State. The 150 m IRF may contribute to a reduction of the total costs for borrowing when compared with a situation where no guarantee is given. A detailed assessment of the impact of this measure in favour of Aer Lingus has to take into account all aspects of the relations between the State and the company, including possible public service commitments accepted by Aer Lingus at the request of the State.

In its Memorandum N° 2 the Commission has recognized that public service commitments may justify certain specific aids compatible with Article 92(1) EEC Treaty (i.e. not affecting trade between Member States), or incompatible and exempted under the provisions of Article 92(3) of the EEC Treaty, provided that the relevant public service objective is in line with the common interest and that the direct or indirect financial support is reasonably related to the additional costs of the public service in question. This would mean in practice that routes operated for public service considerations may be subsidized if no other airline would carry it out.

The public service argument, therefore, always requires full transparency regarding the relations between the aid amount and the specific costs of the particular service. This transparency would not exist if public support was given in the form of general state guarantees for the borrowing of an individual carrier. Consequently, before formulating an opinion about the conformity of this guarantee with Articles 92/93 of the Treaty and eventually proposing appropriate measures, the Commission services need more information about the conditions and the modalities of the guarantee as well as a list of the operations for which the guarantee has already been granted.

. The Commission will pursue this question with the Irish Government.

8. ITALY

8.1 Description

A. DIRECT OPERATIONAL AIDS

Direct operational aids to Italian air carriers exist exclusively for domestic routes. The aids cover operational losses on those routes.

From 1985 to 1988, the annual budget available was 15,750 bn LIT (on total operational losses of 118 bn LIT in 1987). In 1988, the amount was decreased to 13 bn LIT on total operational losses amounting to 159,676 bn LIT. Unfortunately, the Italian authorities have not provided any data concerning the breakdown of these amounts by routes and companies.

The Italian aid system for domestic routes is basically aimed at covering the difference between operating costs and operating revenues on the routes selected. However, the beneficiaries are entitled to deduct 10% of the revenues, so that a certain profit margin is guaranteed.

When allocating the total budget amount (13 bn LIT), priority is given to new routes for which a public interest, based on social, commercial or touristic consideration, is confirmed.

In July 1987, aid of 250 million LIT granted by the Region of Abruzzo to the firm SAGA (Società Abruzzese Gestione Aeroporto) which managed the local airport, was notified to and approved by the Commission. This project was to improve the services of the local airport and, consequently, the traffic of charter flights for tourism.

A project of the Region of Sicily to improve transport infrastructure for touristic purposes is currently under examination by the Commission. Its consequences on air transport seem to be very limited. Therefore, it will not be assessed in this communication.

B. POTENTIAL FINANCIAL AID

According to the information communicated by the Italian Government, no financial aids exist in favour of Italian companies.

C. OTHER

The taxation system does not provide for privileges.

D. FINANCIAL PERFORMANCES

-	ALITALIA			
	. Results:	1988:	52	bn LIT profit
		1989:	151	bn LIT loss
	. Dividend:	1988:	8,756	bn LIT
		1989:	8,846	bn LIT
-	ATI			
	. Results:	1988:	1,09	bn LIT profit
		1989:	71	bn LIT loss

8.2 Assessment

The operational aids granted by the Italian State are exclusively to support domestic lines. Although the total amount of aid (13 bn LIT in 1988) is relatively limited, no accurate data were provided by the Italian Government in order to enable the Commission to assess the impact of the aid, namely to analyse whether or not these aids contribute to diverting significant volumes of international traffic, or allowing carriers to cross-subsidize international routes on which they compete with carriers from other Member States. Therefore, the Commission needs a precise breakdown of the subsidized routes and companies, including figures of traffic and a list of all existing competitors on the routes.

The Commission will pursue this question with the Italian Government.

9. LUXEMBOURG

9.1 Description

A. DIRECT OPERATIONAL AIDS

According to the information presented by the Government of Luxembourg, no direct aid has been granted to Luxembourg air carriers since 1982.

B. POTENTIAL FINANCIAL AIDS

No aid has been given to Luxair in which the State has a 23.11% holding.

The distributed dividend (264.4 M FLux in 1988 namely 9% of the profits; 308.8 M FLux in 1989, 10.4% of the profits; 175.7 M FLux in 1990, 6.7% of the profits) was equally allocated between the state and the private shareholders according to their participation.

Furthermore, no state guarantee to support Luxair's borrowing has been given for years.

C. OTHERS

According to the Luxembourg authorities, no special tax privileges in favour of Luxair and other companies are given. However, the Commission is concerned about the arrangements for operating the Luxembourg airport duty free shop. Some indications suggest that Luxair could benefit from privileges concerning the operation of the duty free shop.

D. RECENT FINANCIAL PERFORMANCES

The profit of Luxair amounted to:

- 4.5 bn FLux in 1988
- 5.2 bn FLux in 1989
- 5.5 bn FLux in 1990.

9.2 Assessment

- . Since no direct aid is given, no observation needs to be made.
- . The Commission estimates that the arrangement for operating the Luxembourg airport duty free shop and, in particular, the function of Luxair in this business, require a detailed examination.  
The Commission will pursue this question with the Luxembourg Government.

10. NETHERLANDS

10.1 Description

A. DIRECT OPERATIONAL AIDS

According to information presented by the Dutch Government, no direct aid has been granted in favour of KLM since 1988 nor to the other Dutch airlines.

However, following an agreement between the Dutch State and KLM for the transfer, as of July 1st, 1991, of the Public Aviation School ("RLS") from the Dutch State to the KLM, the Commission asked the Dutch authorities to give more detailed information on the financial arrangements of this transfer.

B. POTENTIAL FINANCIAL AIDS

(1) Equity

The State, as of 31 March 1991, has a 38,2% holding in KLM. The latest available results of KLM provided by the Dutch authorities were, for the financial year 1989/90: the operating profit was 156 m Dfl. whilst the net gain was 340 millions. KLM paid 33,9 m Dfl. dividends to the State in each of the financial years 1988/89 and 1989/90.

In connection with the minority position of the State in KLM's capital, two option agreements on the purchase of shares were concluded between KLM and the State of the Netherlands in 1985 and 1987. These safeguard agreements allow the State to strengthen its position in KLM when a predominant or majority holding of KLM capital is not demonstrably in Dutch hands or in order to prevent persons or companies to take an undesirable power position at the General Meeting of Shareholders.

Following the 40% stake bought by KLM from Koninklijke Nedloyd Groep in the Dutch charter and scheduled airline operator TRANSAVIA, an agreement has been reached between the European Commission, Dutch Authorities and KLM. This agreement establishes the conditions under which the take-over is approved by the Commission.

(2) Guarantees

Between 1975 and 1985 KLM had the possibility to get state guarantees up to 400 m Dfl. but, according to the Dutch authorities, never made such use of it.



C. OTHER

KLM benefits from special privilege in the duty free business at Schiphol Airport, Amsterdam. In 1965/66 KLM took the initiative to establish a "tax free" shop at Schiphol airport. The company obtained the necessary concession on the basis of a discretionary decision taken by the competent public authorities. In 1968 the N.V. Luchthaven Schiphol, the owner of Schiphol, joined in the "tax free" business. Eversince, both companies have jointly run the tax free business at Schiphol. KLM is holding the concession concerning the sale of alcoholic beverages and tobaccos, but is not involved in other tax free activities.

The Commission needs updated information.

10.2 Assessment

- . No direct or indirect aid supporting the operations of Dutch air carriers is given in the Netherlands. However, the transfer of RLS to KLM is under examination by the Commission with regard to its potential aid elements. The relevant procedure applicable for State aids is followed in this case.

- . Moreover, the arrangements concerning KLM's "tax free" concession for the duty free shop in Amsterdam-Schiphol require a more detailed examination. A situation where Community air carriers are directly engaged in duty free shops is the exception to the rule. Apart from the KLM case, only TAP-Air Portugal and maybe Luxair and SAS are benefitting from such an arrangement.

The fact that KLM obtained its privilege by means of a discretionary decision could constitute an element of aid. But more recent figures are to be provided by the Dutch Government to the Commission in order to decide whether or not this indirect aid constitutes a windfall profit to KLM.

- . The Commission will pursue these questions with the Dutch Government.

11. PORTUGAL

11.1 Description

A. DIRECT OPERATIONAL AIDS

According to information communicated by the Portuguese Government, direct aids aimed at compensating losses sustained by the carrier TAP for operating public services flights between the mainland and the Azores and Madeira have not been paid since 1989.

B. POTENTIAL FINANCIAL AID

(1) A capital injection of 1000 mil Escudos (= 5.9 mil ECU) was made in 1986 in order to improve the financial structure of the company TAP. Recently, the Commission has questioned the Portuguese authorities about possible State aid to be given in the framework of the current privatisation of TAP. The Commission was informed in August 1991 that the Portuguese authorities had not yet taken a decision on the possible State aid to be given. They have also assured the Commission of their intention to carefully respect their obligations pursuant to Article 93(3) of the Treaty when they want to grant any aid.

No subsequent data has been communicated.

(2) Indirect aids in the form of publicly guaranteed loans are not given. However, the Portuguese Government informed the Commission in 1988 that special rules governing public companies (Articles 37 and 38 of the Decree-Law N° 260/76 of 8 April 1976, amended by Decree-Law 29/84 of 20 January 1984) provide that public companies do not fall under the rules governing the dissolution of bankrupt companies. Consequently, the State must ensure the company's financial survival unless it adopts a decree to wind it up. In practice this means that a general guarantee to continue operations is given by the State.

No additional information has been communicated about these rules since 1988.

C. OTHER

(1) The Commission has been informed that TAP benefits from preferential direct and indirect taxation. Further details are unknown to the Commission.

(2) The national carrier TAP enjoys a duty-free concession at the international airports of Lisbon, Porto and Faro. The gross profit resulting from this concession was 1502 mil Esc in 1987 (of which 33% had to be paid to the airport administration) and 2010 mil Esc in 1989 (of which 36% had to be paid to the airport administration).

D. RECENT FINANCIAL PERFORMANCES

The latest available results of TAP provided by the Portuguese authorities were a loss of 7581 mil Esc. in the financial year 1989.

11.2 Assessment

- . According to the Portuguese authorities, no more aids to support Portuguese air carriers are given in Portugal.
- . The capital injection in favour of TAP and which was carried out in 1986 was not notified to the Commission. However, the current privatisation of TAP, which aims to solve the structural problems of this company, has to take place under the scrutiny of the Commission. Following a notice by the Commission, the Portuguese authorities have committed themselves, on 8 August 1991, to respect their obligations pursuant to Article 93(3) of the Treaty as soon as State aid measures will be considered.
- . The general guarantee resulting from the national legislation on public companies would represent, if it still exists, a major aid element in favour of TAP. Consequently, the Commission services would like to have updated information on this guarantee and its existence.
- . The Commission is aware that TAP benefits from certain taxation advantages. However, they have never been mentioned by the Portuguese authorities. The Commission considers a priori sectoral privileges in the area of direct taxation as State aid.  
In general, with respect to indirect taxation, the Commission reserves its position until the results of the present Council negotiation (following the political agreement reached on June 24, 1991) on the harmonisation of indirect taxation will be known. However, to get a clear view on the whole tax situation of the aviation sector, the Commission requires information about both direct and indirect taxation in order to make an assessment.
- . The arrangements concerning TAP's "tax free" concession for the duty free shops in Lisbon, Porto and Faro suggest that this concession was given to TAP by discretionary decision of the competent authorities. A situation where Community air carriers are directly engaged in duty free shops is the exception to the rule. Apart from the TAP case, only KLM and maybe Luxair and SAS are benefitting from such an arrangement. This could lead to a competition distorting windfall profit, a situation which could not be sanctioned by the Commission. The Commission will consequently request a detailed report on the operations of TAP "tax free" concessions.

. The Commission will pursue these questions with the Portuguese Government.

12. UNITED KINGDOM

12.1 Description

A. DIRECT OPERATIONAL AIDS

(1a) In 1984 the white paper on airline competition policy issued by H.M. Government announced a scheme whereby British Airways (BA still being a public company) offered to help independent airlines, other than British Caledonian, with up to £ 450,000 per route, spread over three years, to meet some of the development costs and to support services related to starting up new routes. The offer was good for a maximum of 15 routes from the six regional airports at which BA then operated, irrespective of whether the routes to be opened were completely new or already served by BA. The assistance was payable in three instalments (£ 225,000 in year 1; £ 150,000 in year 2 and £ 75,000 in year three). Following the final payment in April 1990, the scheme was wound up. The total amounts paid to the various airlines are as follows:

<u>Airline</u>	<u>Route</u>	<u>Aid received (£)</u>
Ace Aviation	Glasgow/Brussels	225,000
	Glasgow/Hamburg	225,000
Air Ecosse	Glasgow/Dublin	225,000
Air Europe	Manchester/Gibraltar	450,000
Birmingham	Birmingham/Amsterdam	450,000
Executive Airways	Birmingham/Dusseldorf	450,000
	Birmingham/Frankfurt	450,000
	Birmingham/Oslo	450,000
Connectair	Manchester/Rotterdam	450,000
Dan-Air	Manchester/Amsterdam	450,000
	Manchester/Oslo	450,000
Euroair	Dundee/Esbjerg	450,000
Suckling Aviation	Manchester/Amsterdam (via Ipswich)	450,000
TOTAL AID RECEIVED		<u>5,175,000</u>

This aid scheme was examined and approved by the Commission (Aid N° 192/86).

(1b) Highland Express: In December 1984, the Industry Department for Scotland (now the Scottish Office Industry Department) made an offer of £ 2,000,000 to the Highland Express airline, under the Office and Service Industries Scheme (pursuant to the Industry Act 1982). A payment of £ 1,000,000 was made to Highland Express to meet the capital costs of start-up and to create jobs at Prestwick. This investment aid was granted in the framework of a regional aid scheme approved in 1984 by the Commission (Aid N° 331/84). Highland Express was, however, placed in the hands of the Receiver in February 1988 and no further payments were made.

(1c) Chieftain Airways PLC: An offer of Regional Selective Assistance, under the 1982 Industry Act, was made to Glasgow-based Chieftain Airways in August 1986. The offer of £ 400,000 was intended to meet start-up costs and to create jobs. Although the offer was accepted, the company went into receivership in July 1987 and the project did not proceed.

(1d) Scottish European Airways Ltd: Regional Selective Assistance of £ 500,000 was offered in 1988 to assist with the acquisition of aircraft for this newly formed company and to create jobs at Glasgow. Two payments were made under the offer - £ 100,000 in December 1988 and £ 200,000 in May 1989. The offer was superseded by a new project and the balance was not paid.

The new project, to use jet aircraft to expand the range of existing services thus including six new European destinations, attracted an offer of Regional Selective Assistance, designed to facilitate aircraft purchase, safeguard jobs and create new ones. The company was placed in Administration in May 1990, and no further payment was made.

(1e) Loganair: Under the provisions of the Highlands and Islands Air Services (Scotland) Act 1980, the UK Government offers subsidies to meet deficits of socially necessary, though uneconomic, services in the Scottish Highlands and Islands. Currently Loganair only receives a subsidy for the operation of services linking the islands of Tiree and Barra with the mainland (Glasgow).

The authorities of the UK affirm that the main objective of the grant is to ensure that the isolated island communities continue to have an air link with the mainland. Without this subsidy, air services to these islands would be withdrawn.

(1f) Highland and Islands Airports Ltd: HIAL, a subsidiary of the Civil Aviation Authority, receives a deficit subsidy from the Secretary of State for Scotland, in accordance with Section 34(1)9b) of the Civil Aviation Act 1982, to cover the current cost of operating eight airports in the Highlands and Islands region. These airports (Islay, Tiree, Kirkwall, Benbecula, Stornoway, Sumburgh, Inverness and Wick) provide facilities for essential "lifeline" air services. The subsidy ensures the continuation of operations at these airports and allows airport charges for domestic flights to be contained at acceptable levels, ensuring that scheduled services continue to serve the local communities. This is in line with the UK Government's general objective of maintaining population and promoting economic growth in the region.

	1988/89	1989/90	1990/91.
Total deficit	3,500,000	3,200,000	3,400,000
subsidy paid to HIAL (£ )			
Total number of passengers	558,457	594,526	604,835

- (1g) The Commission notes that no direct aid was granted to British Airways.
- (2) Use of certain types of aircrafts:  
No aids of this type are granted (Concorde operates at BA's own risk).

#### B. POTENTIAL FINANCIAL AID

(1) Equity

British Airways was privatised in February 1987.  
As of 31 March 1991, H.M.'s Government held 2,483,606 shares in the company. Authorised share capital was £ 180 m from 1985 to 1987. It was increased in January 1987 to £ 240m and again in August 1987 to £ 267m. In both 1989/90 and 1990/91 an interim dividend of 2,80p. per share and a final dividend of 6,09p. per share were paid.

(2) Guarantees

The State does not guarantee BA's borrowing.

(3) Borrowing

Normal commercial arrangements apply to all of BA's borrowing.

#### C. OTHER

(1) Taxation

- Under Section 61 of the Customs and Excise Management Act 1979, airlines operating services to countries outside the UK may ship stores for in-flight use (including goods for retail sale to passengers) free of customs and excise duties. Such stores are also zero-rated for V.A.T. by virtue of Section 16(6) of the VAT Act 1983, while excise duty on fuel used during an international flight may also be reclaimed.
- Airlines enjoy relief from VAT charges in the following circumstances, under group 10 of Schedule 5 to the VAT Act 1983:
  - a) the supply of commercial aircraft including normal fixed, loose and navigational equipment is zero-rated;
  - b) the repair and maintenance of commercial aircraft is zero-rated, provided any component removed for repair is replaced in the same aircraft. This includes the modification and updating of equipment;

c) handling services in a customs and excise airport are zero-rated. Such services include compass swinging fees, housing and navigation services, and security services (i.e. checking passengers for explosives, etc.).

- British Airways is taxed the same way as other companies.

D. RECENT FINANCIAL PERFORMANCE

British Airways:	-	consolidated profit before taxation
1987		+227.5 £ M
1988		+268.1 £ M
1989		+344.7 £ M
- dividends		
1987		49.7 £ M
1988		55.8 £ M
1989		63.8 £ M
Air 2000:	-	profit before taxation
1989		+9.418 £ M
- dividends		
1989		----
Air Bridge		
Carriers:	-	profit before taxation
1989		+1.001 £ M
- dividends		
1989		0.391 £ M
Air Europe:		not communicated (in bankruptcy)
Air U.K.:	-	profit before taxation
1989		+1.972 £ M
- dividends		
1989		----
Britannia Airways:	-	profit before taxation
1989		+22.504 £ M
- dividends		
1989		+ 7.000 £ M
British Air Ferries:	-	profit before taxation
1989		+ 1.051 £ M
- dividends		
1989		----
British Islands		
Airways:	-	profit before taxation
1989		+ 0.489 £ M
- dividends		
1989		----



. Heavylift Cargo	
Airlines: -	profit before taxation
1989	+0.377 f M
- dividends	
1989	-----
. Monarch Airlines: - profit before taxation	
1989	+6.521 f M
- dividends	
1989	-----
. Virgin Atlantic	
Airways: -	profit before taxation
1989	+7.521 f M
- dividends	
1989	5.000 f M

## 12.2 Assessment

. Direct operational aids can be classified into three different types:

(1) aids granted in order to promote domestic air services (Loganair, Highlands and Islands Airports): these are exclusively aimed at ensuring public services requirements such as essential lifeline air services and linking remote regions to the mainland. Consequently, they can be considered as totally compatible with the relevant criteria, namely as not affecting trade between Member States, not contributing to divert significant volumes of international traffic into the Member State in question, not allowing air carriers to cross-subsidize their international operations and as promoting regional development.

(2) aids granted in order to promote regional (intra-Community) air services (British Airways support to regional carrier; Scottish European Airways): the Commission approved in 1986 the regional aid scheme under which British Airways provided financial assistance to independent airlines established in the United Kingdom. This approval was made taking account of the Commission's policy to promote regional services (Directive 83/416). As BA was at that time wholly-owned by the U.K. Government, the assistance had been assessed under the provisions of Articles 92/93 of the Treaty.

This scheme has been wound up following the final payment in April 1990.

The project of expanding the range of existing services of Scottish European Airways Ltd in order to include six new European destinations was not notified to the Commission. The company was placed into administration in May 1990. The Commission needs updated information on this case.

(3) regional aid schemes aimed at meeting start-up costs and of creating jobs (Highland Express, Chieftain Airways PLC, Scottish European Airways Ltd): developed under the Office and Services Industries Scheme pursuant to the Industry Act of 1982. If investment aid was granted to Highland Express in the framework of a regional aid scheme approved in 1984 by the Commission, the Commission was not informed about the respective aids to Chieftain Airways and Scottish European Airways. However, with the amounts involved and the placement into receivership or administration of the three above-mentioned companies no further action is required.

- . As regards VAT exonerations it should be taken into account that zero-rating for international flights, including the VAT on the necessary equipment, represents international practice which is based on ICAO recommendations. The information presented by the UK Government seems to indicate, however, that also all equipment purchases for use on domestic operations enjoy complete relief from VAT charges. Therefore, this area will have to be re-examined in the light of the final results of the Council negotiations on the harmonization of indirect taxes.
  
- . The Commission will pursue the case of Scottish European Airways Ltd. with H.M. Government.

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ANNEXES I & II

The SABENA and AIR FRANCE cases

THE SABENA CASE

1. The Sabena case could be considered as an example of the Commission's policy to give airlines supporting past financial burdens a chance for a fresh start within the framework of a reorganization programme aimed at regaining commercial viability.

Sabena's situation at the beginning of 1991 was alarming: in the past five years, the load factor had fallen from 74% to 64.4% (to 54.8% on European scheduled services, which was Europe's poorest performance - Source: Avmark Aviation Economist) whilst over the same period the working force increased from 8,600 to 12,180 employees. A third of the employees are in Sabena's non-airline business.

The financial situation was difficult: following the 1989 and 1990 operational losses (respectively BF 1.25 billion and BF 7.462 billion), cumulated losses reached BF 42.2 billion in 1991 (BF 17 billion in 1984).

With a capital amounting to BF 9 billion, the resulting debt-equity ratio of about 4:1 was, compared with normal standards of the aviation industry, very poor.

Furthermore, the more decentralized management structure launched in the eighties and the "Sabena World Airways" (SWA) joint venture with British Airways and KLM (in 1990) did not achieve the expected results and complicated Sabena's accounts to such an extent which, today, makes any comparison between yearly results virtually impossible.

A 54.72% State holding in Sabena and a long tradition of interventionism have led to specific company characteristics: non commercial statutes including privileged state-held shares and guaranteed dividends; interest subsidies; general guarantee of the State for financial obligations; direct operational aids (until 1986); monopoly of designation of scheduled services, .....

The Community's general air transport policy as well as the specific intervention of the Commission have led the Belgian authorities to liberalize access to the Belgian market to a certain extent.

However, the structural defects of the company remained basically unchanged. The failure in January 1991 of the one year old "SWA" joint venture agreement with British Airways and KLM and the bad 1990 financial results led Sabena to draft a radical restructuring plan to regain commercial viability.

2. The plan, notified to the Commission on 5 April 1991, contains two different phases, which are necessarily interlinked.

The first stage involves a massive "clean up" of the burden resulting from the past: a substantial part of the debts are transferred into Sabena's capital which is simultaneously increased by two injections (respectively a transfer of reserves and a cash injection). At this stage, the State gives up its former debt and finances the social part of the programme. These capital increases are followed by a capital reduction aimed at wiping out the losses.

At a second stage, an additional state injection amounting to BF 9 billions is subject to the participation of new industrial partners and Belgian private shareholders in the recapitalisation programme.

Upon the completion of the programme, it is foreseen that the Belgian State will only have a 26.7% stake in the capital of the company while the industrial partners (40%), the Belgian private shareholders (26.7%) and the staff (6%). In concrete terms, the Belgian Government bases its participation in restructuring Sabena on the double condition that the company is commercially viable in future and finds a reliable industrial partner (airline) for future cooperation.

The Belgian authorities have furthermore informed the Commission of Sabena's intention to reduce its permanent staff from 12,180 in 1991 to about 9,000 towards the end of 1993.

3. After examination of the plan in accordance with Articles 92/93 of the Treaty, the Commission arrived at the conclusion that the proposals notified by the Belgian Government had to be regarded as State aid within the meaning of Article 92(1) of the EEC Treaty.

However, the Commission may consider some restructuring aid as compatible with the common market under Article 92(3)(c) of the Treaty for "aid to facilitate the development of certain economic activities". The criteria of Article 92(3)(c) are elucidated in the Commission's Memorandum N° 2, which stipulates that aid may be granted to individual airlines which have serious financial difficulties, provided certain conditions are met. The aid cannot be of unlimited duration, should form part of a programme approved by the Commission, and restore the airline's viability so that within a reasonably short period it can be expected to operate without further aid.

4. The question whether the proposed support for Sabena goes beyond the level required for the purpose of restoring the company's viability has been assessed by the Commission in a broader context taking account of the aeropolitical environment.

In this context, the intention of Sabena to reduce the staff by 29% and the willingness of the Belgian State to compensate for the cost of these lay-offs can be seen as important steps for regaining commercial viability. Also important was the wish to make full use of the market potential Brussels airport offers.

Additional resources will improve the debt-equity ratio by the writing off of the accumulated debt and will serve to modernize the fleet, thus lowering operating cost.

Furthermore, these investments will not increase the capacity offered by Sabena; on the contrary, the restructuring of Sabena's network towards profitable routes will initially lead to a reduction of capacity.

5. On 24 July 1991, the Commission took its decision. The Commission accepted, under Art. 93(3)(c), the Belgian aid programme and restructuring plan to be implemented by 1995, with the reservation that the Belgian authorities respect five specific conditions:

- to abstain from granting any further aid or other new measures favouring directly or indirectly SABENA or lowering the commercial risks of its shareholders;
- not to grant any form of privileged treatment to SABENA in relation to other Belgian air carriers with regard to designation of traffic rights and in relation to all Community air carriers regarding slot allocation, ground handling, catering and other airport related activities;
- to transform privileged shares ("actions privilégiées") with effect from 31 December 1992 at the latest into normal risk shares ("parts sociales");
- to base the new company statutes on private commercial law thereby excluding the Belgian State from intervening for other than commercial reasons, and to forward the new Statutes to the Commission upon their adoption;
- to implement the restructuration plan by the end of 1995 in accordance with the procedures notified to the Commission and not to subscribe to the increase in capital provided for during the second stage of the restructuring plan unless an industrial partner subscribes to a significant proportion of that increase.

6. In the meantime, the Belgian authorities have once more confirmed their abstention from granting any further aid and their renouncement to favour Sabena with regard to other Belgian and European air carriers.

State-held shares have been transformed into normal capital, rules related to guaranteed dividends are being modified and the new Statutes are being drafted (their approval by Decree is suspended until the new Belgian Government is constituted).

As a consequence of the governmental crisis in Belgium no decisions have been taken about the choice of an industrial partner, although candidates are well known. Accordingly, the Belgian Government has not yet increased Sabena's capital as foreseen in the second stage of the agreement. Instead, the Belgian authorities have communicated to the Commission that Sabena is to receive a BF 3 billion transitory credit under normal market conditions. These conditions are being examined by the Commission.

Already some 1,600 employees have been made redundant and 461 will leave Sabena by June 1992. The workforce is expected to have declined by 14.1% to 10,387 by the end of 1992.

Sabena's results over the year 1991 have been encouraging: from April to December 1991 Sabena has made a net profit of BF 50 million and an operating profit of BF 2.13 billion.

The Commission will continue to follow the evolution of Sabena's restructuring plan to ensure strict respect of the conditions laid down by the Commission in its Decision by the Belgian authorities.

## THE AIR FRANCE CASE

1. Even though this case is not considered as state aid, it is nevertheless interesting in the framework of the application of Articles 92 and 93 of the Treaty. In this important case, the Commission acknowledges that a State owned air carrier may have a justified need for additional own capital to realize an investment programme necessary to improve efficiency and competitiveness.

Capital increases of State owned companies which could constitute state aid, must be notified to the Commission like all other financial injections. They are examined by the Commission in accordance with Art. 92 and 93 of the Treaty, to determine if they constitute aid. A capital increase is not aid if one can assume that a private investor in a comparable situation would take a similar decision (market economy investor principle). Short term as well as long term aspects have to be taken into account. The Commission's conclusion on the present case is specific to the situation of the company concerned. Air France is generally efficient and has good prospects for further development. Capital increases of other companies will be evaluated on their own specific merits.

2. Groupe Air France results from the merger of Air France with Air Inter and UTA which entered into force on January 12, 1990. The merger took place without any financial intervention of the State.

Groupe Air France is an important European air carrier which, on December 31, 1990 operated 221 planes (Air France 114, UTA 16, Air Inter 75, other 38).

Net consolidated profits of the Groupe reached 1.152 million FF in 1988 and 841 million FF in 1989, but 1990 shows a loss of 718.2 million FF.

In October 1991, the French State held almost all (98.5%) of the Air France shares.

3. Following the merger and the 1990' losses a comprehensive restructuration plan was drafted at the end of 1990. This plan included the objectives to be achieved by the Groupe Air France. It outlined certain temporary and structural sector problems as well as specific company problems necessitating an improvement of its financial structure. It projected capital injections to be realized during the period 1991-1993 including a 2 billion FF direct capital injection from the State to be carried out in 1991.



At the Commission's request, the French authorities communicated to the Commission, by letters and meetings, all the necessary information to allow the Commission to assess the capital increase of 2 billion FF.

In its assessment under the so-called market economy investor principle, the Commission has taken into consideration both the short term situation and the long term prospects of Air France.

Short term assessment of the general situation of the airline industry indicates that due to cost pressure and traffic slumps resulting from the Gulf crisis, operating results of airlines (including Air France) deteriorated considerably in 1990 and 1991. The Gulf crisis had taken its toll just when the company was implementing a restructuring plan that included absorbing Air Inter and UTA.

However, Air France's productivity and efficiency levels are, on average, relatively good if compared with a number of European competitors. The company does not suffer from a lack of efficiency in relation to other European companies. Operating profits over the past year demonstrate that those of Air France do not differ significantly from those of other European air carriers.

Long term projections on the future development of air traffic suggest that the air transport industry will produce growth rates clearly above the average GNP growth rate. A doubling of the number of passengers during the next 10 to 12 years is forecasted.

4. Therefore, the Commission has examined whether the structure and the volume of the debts of Air France would be such that a return to normal dividends and capital gains could be expected within a reasonable time. Indeed, recent Court of Justice decisions (1) have indicated that "it is necessary to make clear that the behaviour of a private investor with which the intervention of the public investor must be compared, whilst not necessarily that of an ordinary investor placing his capital with a more or less short term view of his profitability, must at least be that of a private holding or group which pursues a structural, global or sectoral policy and which are guided by a longer term of profitability".

The Commission concluded, in brief, that the financial projections on the overall return on investments resulting from the capital injection in 1991 demonstrate a favorable outlook for Air France over the coming years.

In addition, Air France's home base (Paris-Roissy) is well located and does not suffer from infrastructure bottlenecks. The airline is therefore well prepared to benefit from future growth.

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(1) See cases C 305/89 (Alfa/Fiat) and C 303/88 (ENI/Lanerossi).

Even though Air France's short term problems resulting from various factors - mainly the market disruption due to the Gulf crisis simultaneous with the restructuring process with UTA and Air Inter - suggest the existence of a state aid element in the capital increase, long term considerations indicate that the operation is in line with the market economy investor principle. In the present situation, any owner, private or public, would have good reasons to improve the financial structure of the company with a view to re-establishing financial soundness and competitive operating patterns in order to benefit eventually from its sustained viability.

In the light of this conclusion, the Commission has considered the capital increase of 2 billion FF as a normal commercial transaction. However, the Commission has reserved its position on the capital injections to be carried out in 1992 and 1993.

The French Government has been requested to inform the Commission in sufficient time to enable it to submit its comments on the modalities concerning the future operations.

Subsequently, the Commission has been informed of a 1.25 billion FF injection by the Banque Nationale de Paris. The Commission is presently assessing this latest development and will take its decision in due time.