COMMISSION

COMMISSION DECISION
of 22 July 1998
on aid granted by France in connection with the recapitalisation and transfer of the assets of Société de Banque Occidentale (SDBO)
(notified under document number C(1998) 2406)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given the parties concerned the opportunity to submit their comments, in accordance with the above-mentioned Articles,

Whereas:

I. ARTICLES 93(2) PROCEDURE

By letter dated 3 October 1996 the Commission notified the French authorities of its decision of 18 September 1998 (1) to initiate the Article 93(2) procedure in respect of the aid granted to Société de Banque Occidentale (SDBO) and to Crédit Lyonnais (CL) in connection with the transfer of part of SDBO through Consortium de Réalisations (CDR) to Banque des Échanges Internationaux (BDEI), a CL subsidiary. CDR is the hive-off vehicle set up in 1995 under the second CL restructuring plan, for containing CL’s non-performing assets, including SDBO. The resale of the healthy part of SDBO to CL, agreed at the beginning of 1996, took place on 28 June 1996, with retroactive effect from 1 January 1996. The Commission learned by letter from CL dated 7 August 1997 that the SDBO assets in question had finally been transferred to Banque de l’Ile-de-France, a CL subsidiary.

The transaction was part of the Crédit Lyonnais restructuring plan which the Commission examined in 1995 and 1998 and approved, subject to certain conditions, in Decision 95/547/EC of 26 July 1995 giving conditional approval to the aid granted by France to the bank Crédit Lyonnais (2) and in Decision 98/490/EC (3). It was in particular stipulated in Decision 95/547/EC that the healthy parts of the banking subsidiaries hived off to CDR would either be sold off to third parties or returned to CL before 31 December 1995, so that no active banking organisation would be retained in CDR after that date.

As part of the procedure initiated on 18 September 1996, new information on the amount of capital injected and the value of the SDBO assets sold by CDR to CL was submitted by the French authorities to the Commission. As the information was likely substantially to modify the assessment of State aid contained in the measures in question, the Commission decided on 2 April 1997 to extend the procedure initiated on 18 September 1996 pursuant to Article 93(2) of the Treaty (1).

II. DESCRIPTION OF THE MEASURES COVERED BY THIS PROCEDURE

(i) Background to the transaction

SDBO, set up in 1981 through a merger of two medium-sized banks, was a subsidiary of CL until 1995, at which time it was transferred to the CL hive-off structure, CDR, as part of the overall rescue plan for CL. SDBO carried on a conventional banking business with a clientele of mainly small and medium-sized enterprises, and offered a range of commercial banking services, market products, asset management and financial engineering products. A large proportion of its clientele was involved in commercial-court business, property with a strong commercial presence in respect of estate agents, the art market and goodwill-financing in the hotel and catering trade. SDBO’s activities grew very rapidly until 1992, chiefly as a result of a sharp increase in its lending to the property market, which totalled FRF 7.6 billion at the end of 1992 out of a total balance sheet of FRF 21.7 billion — an unreasonable concentration of its risks in a sector of which it had little experience before the mid-1980s and in which it did not have any special know-how. At the beginning of 1990, the slide of the property market began to have dramatic effects on its business. That decline, together with a very difficult economic climate in general, resulted in SDBO’s making provision for default on a large proportion of its lending. It was also penalised by inadequate risk control and a concentration of risk on a few very major clients who proved unable to meet their obligations (e.g. Immopar and the Tapie group). The crisis created considerable operating losses of FRF 159 million in 1992, FRF 643 million in 1993 and FRF 468 million in 1994 (2).

In 1993, SDBO withdrew from its property activities and transferred its property assets to CL’s property hive-off, OIG (Omnium immobilier de gestion). SDBO was pared down to the basic banking services and, in 1995, implemented a social plan to cut the workforce from 372 to 242 employees. In 1995 it was transferred to CDR with the other hived-off CL assets. According to information already sent in 1995 to the Commission by the French authorities, the value at which SDBO was transferred to CDR included FRF 578 million in securities and FRF 2.487 billion in loans, representing a contribution to the hive-off amounting to a total asset value of FRF 3.065 billion.

In 1995, SDBO’s financial position worsened further. It experienced a spectacular drop in business owing to a reduction in customers’ deposits from FRF 4.5 billion at the end of 1994 to FRF 2.4 billion at the end of 1995. The use of clients’ funds fell from FRF 8.8 billion to FRF 7 billion. The bank’s total balance sheet was slashed by some FRF 5 billion, from FRF 17 billion to FRF 12.1 billion. The conditions in which the bank operated continued, owing to the trend in its commercial activities, to generate considerable losses: net receipts from banking, having been in deficit for several years, settled at the minus FRF 506 million mark. As a result of the losses, its own funds were completely exhausted. Once the result for 1985 had been added (and before recapitalisation), SDBO’s own capital had fallen to FRF 104 million, which meant that, without recapitalisation by CDR or a potential buyer, its banking licence would have been withdrawn since the solvency ratio would have been below the legal minimum, and it would probably have been wound up.

### Table 1

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<tr>
<td>Overall net receipts from banking</td>
<td>422</td>
<td>431</td>
<td>485</td>
<td>290</td>
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<tr>
<td>Overheads and depreciation</td>
<td>247</td>
<td>288</td>
<td>276</td>
<td>272</td>
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<tr>
<td>Gross operating result</td>
<td>175</td>
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<td>208</td>
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<tr>
<td>Net result</td>
<td>−159</td>
<td>−643</td>
<td>−468</td>
<td>−506</td>
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<tr>
<td>Total balance sheet</td>
<td>21 750</td>
<td>21 393</td>
<td>17 020</td>
<td>12 128</td>
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<tr>
<td>Own capital</td>
<td>917</td>
<td>798</td>
<td>535</td>
<td>104</td>
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At the end of 1995, CDR defined an entity that could be sold, the ‘sound’ bank, and entrusted its valuation and sale to Compagnie Financière Edmond de Rothschild (CFER). In November 1995 CFER produced a document assessing the value of SDBO and setting out a commercial recovery plan for the new entity (the ‘sound’ bank). The valuation

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(1) OJ C 207, 8.7.1997, p. 5.
(2) Net result of the financial year.
took account of several methods currently used in this type of analysis of the value of a firm: the revalued net assets method, the stock exchange comparison method and the 'available' (discounted) cash-flow method. The three methods provided a very wide range of values for the healthy parts of SDBO, ranging from minus FRF 134 million (available flow method) and minus FRF 18 million (stock-exchange comparison method) to FRF 51 million (revalued net assets method). The average value of the healthy parts of SDBO, on the basis of the three methods, was thus minus FRF 34 million. The document stated clearly that it would be necessary to recapitalise the healthy parts of SDBO, valued at FRF 207 million, and that this would be paid for by the purchaser of the 'sound' bank.

This document was then sent in January 1996 to eight French banks selected as potential acquirers of the 'sound' bank, and to CL. The transaction with CL took place, although the final arrangements had not yet been fully defined, on 2 February with the signing between CDR and CL of an agreement on the transfer of a complete branch of SDBO. The agreement stipulates that the partial transfer includes assets, liabilities, performing off-balance sheet commitments and plant. It was extended by a supplementary agreement of 20 March 1996. On 21 May 1996 SDBO and BDEI (Banque des Échanges Internationaux, a CL subsidiary) included an asset transfer agreement. The agreement stipulates that, as SDBO would, under CDR's terms of reference, lose its banking licence, the sale to BDEI for FRF 50 million of a package of the assets and liabilities needed to keep its banking business going would best enhance the potential of that package. The transfer would be backdated to 1 January 1996. The agreement was confirmed at an SDBO extraordinary shareholders meeting on 28 June 1996.

(ii) Reasons for initiating the Article 93(2) procedure on 18 September 1996

At the time, the Commission took the view that the following measures connected with the transfer of part of SDBO to CL were likely to contain aid: (i) the conditions attached to the sale of SDBO; (ii) the capital injected by CDR before the sale of the healthy part of SDBO to CL; (iii) the price paid by CL for regaining the healthy part of SDBO (FRF 50 million); (iv) the payment made by CL to CDR in the form of preference shares.

First, the terms on which the healthy part of SDBO was sold to CL by CDR did not at first sight appear to comply with the normal rules of impartiality that could be expected. In particular, CDR had not put out any unconditional, competitive tender. All eight banks invited early in 1996 to express an interest were French. CFER, acting as an agent for CDR, had contacted the eight preselected potential buyers on the basis of the buyer's injecting sufficient capital to restore own funds to the requisite level and cover forecast requirements, the amount being estimated at FRF 207 million. CDR received only two bids, from CL and Banque Delubac, and did not select the latter as it covered only a limited number of assets. However, as was pointed out by the Commission when it initiated the Article 93(2) procedure, CDR had finally decided to recapitalise the part transferred to SDBO before its sale to CL. The last-minute recapitalisation at the expense of the vendor was not notified to the eight banks originally contacted, which were thus not given the opportunity to make an offer on the basis of the new position.

Secondly, the Commission took the view in its notice on the initiation of this procedure that the recapitalisation by CDR in 1996 of the disposable part of SDBO, which had not been notified to it, was liable to contain a considerable proportion of State aid. In particular, it pointed out that the liquidation costs were not necessarily higher, as the French authorities believed, than the costs of recapitalisation and disposal. Nor was it proven that the recapitalisation was in proportion to the absolute minimum required.

Thirdly, in its notice of 18 September 1996, the Commission took the view, on the basis of data submitted earlier by the French authorities, that the price of the sale to CL — FRF 50 million — was below the average value of the healthy part of SDBO as defined by the bank advising CDR (namely, FRF 173 million after the injection of the FRF 207 million originally planned), revealing a loss incurred by CDR on the selling price and corresponding aid to CL.

Fourthly, the Commission had taken the view in its initiation of the procedure that the use of CL preference shares to pay for its acquisition could contain elements of State aid, and infringed Decision 95/547/EC.

III. COMMENTS OF OTHER INTERESTED PARTIES

(i) The Commission received two sets of comments following publication of the procedure in the Official Journal of the European Communities.

The United Kingdom submitted its comments by letter of 13 December 1996, stressing the importance it attached
to the need for State aid, such as that approved by the Commission in 1995 under the CL restructuring plan, to be granted once only, in full and final settlement.

Société Générale, which was one of the banks selected by CDR on the recommendation of its advisory bank with a view to the purchase of the healthy part of SDBO, informed the Commission by letter of 4 December 1996 that it agreed with the analysis set out by the Commission in its notice on the sales procedure adopted by CDR. Société Générale had been contacted at the beginning of 1996 by the bank advising CDR only on the basis of recapitalisation at the expense of the buyer of the transferable part of SDBO. Société Générale considered that the cost of acquiring the relevant branch of SDBO would consist of FRF 50 million (revalued net assets of the healthy part of the bank) and the cost of the recapitalisation (FRF 207 million), giving a total cost of FRF 257 million. Société Générale states that, on this basis, it had declined the invitation to tender, that it had not been informed by CDR of changes to its decision to recapitalise the relevant parts of SDBO prior to its sale and that it had only subsequently learned through the press of the altered terms on which CL had acquired the healthy part of SDBO. Société Générale considered that Crédit Lyonnais had thus benefited from aid.

In reply to the Commission notice on the initiation of the present procedure, the authorities stated in their letter of 11 November 1996 that the small number of banks contacted by the bank advising CDR was due to the limited value of such an acquisition to French and European banking establishments. They stressed that a sale was necessary as quickly as possible in order to offset the erosion of the bank’s image due to disputes concerning some of its loans, which justified the simplified procedure adopted. By letter dated 29 January 1997 the authorities considered that the fact that the value calculated by the bank advising CDR was negative necessitated, in order for the sale to take place, prior recapitalisation by the vendor, irrespective of the buyer. If the capital had been injected by the buyer, the selling price would have been negative, which would have entailed payment of the value of the healthy part of SDBO by the vendor to the purchaser. According to the French authorities, such a transaction would have involved material difficulties. They added in their letter of 13 June 1997 that the preliminary tender specifications clearly showed that the value of the assets to be transferred was negative before recapitalisation. They attached a letter from CFER showing the very tight deadlines imposed on the transaction, in view of the crisis in the operation of SDBO, which meant that the banks originally approached could be contacted only by telephone. CFER also stated that the question of recapitalisation by the buyer was simply a working hypothesis with no immediate bargaining value, as the value of the business being sold was negative.

According to the French authorities, CDR rejected the bid by Banque Delubac, the only one submitted by the eight banks contacted, because it covered too few of the assets and activities of SDBO, leaving too high a restructuring cost for CDR.

IV. COMMENTS OF THE FRENCH AUTHORITIES

By letter dated 11 November 1996 the French authorities presented their comments in defence of the measures concerned by the Article 93(2) procedure. They enlarged on their comments by letter dated 29 January 1997. As the letters in question resulted in the Commission’s extending the procedure, the French authorities sent additional comments on the extended procedure by letter dated 13 June 1997.

The recapitalisation of the healthy part of SDBO was, according to the French authorities, re-estimated at FRF 274.5 million at the beginning of 1996. In comparison with the initial estimate of FRF 207 million presented to the eight banks questioned in January of the same year, the increase was due to the need to allocate FRF 57.5 million to the fund for general banking risks in order to consolidate the solvency ratio and the need for FRF 10 million more own funds because of the FRF 400 million increase in the volume of assets to be sold.
However, the recapitalisation actually made in the end was lower: FRF 240,5 million. The French authorities explained this by the fact that the advisory bank CFER had reassessed the value of the assets on the basis of revised estimates made at the beginning of 1996.

(iii) Valuation of the SDBO assets sold. Selling price

By letters of 11 November 1996 and 27 January 1997 the French authorities sent the following comments on the value of the healthy part of SDBO sold to CL.

First, they took the view that, of the different methods for estimating the value of the healthy part of SDBO (discounted cash flows, stock exchange comparisons and revalued net assets), it was proper to prefer the discounted cash flow method producing a negative value, initially estimated at minus FRF 134 million. In support of this view, they have pointed to the concern of potential buyers to prevent such a purchase from having adverse repercussions on their own profitability. This prompted the French authorities to disregard the estimate of the revalued net assets carried out by the bank advising CDR, which had arrived at a higher value (FRF 51 million before recapitalisation), and the valuation made by the advisory bank in the document submitted to potential purchasers, by calculating the average of the values arrived at by the three methods, which produce an estimated negative value of minus FRF 34 million (before recapitalisation).

The French authorities then informed the Commission that the value of the transferred part of SDBO had been revised at the beginning of 1996 by the bank advising CDR. The net receipts from banking were thus revised downwards by FRF 16 million for 1996. An identical correction to the net receipts from banking had been made for the forecasts for the following years. The discounted cash flow method thus resulted in an average negative net value before recapitalisation of minus FRF 220 million instead of minus FRF 134 million set out in the previous CFER reference document.

Taking account of the two factors, the value of the part of SDBO sold after a capital injection of FRF 240,5 million amounts, according to the French authorities, to FRF 20,5 million. As CL purchased the business for FRF 50 million, it is not possible, according to the French authorities, to conclude, as the Commission did in its decision of 18 September 1996 initiating the procedure, that CL benefited from State aid in the form of an under-valuation of the price obtained by CDR, the transfer having on the contrary produced extra value in relation to the real value of the assets sold to CL.

The Commission having questioned the French authorities in its notice of 2 April 1997 extending the present procedure concerning the difference between the value of FRF 20,5 million after recapitalisation and the price of FRF 50 million paid by Crédit Lyonnais, the French authorities replied by letter of 13 June 1997 that the difference was due to a final adjustment in the volume of the assets to be sold and to the different valuation methods used by CFER, so that the reference values for valuing the business ranged from minus FRF 195 million to minus FRF 236,7 million before recapitalisation — a range after recapitalisation of FRF 45,5 million to FRF 3,8 million. They attached a letter from CFER which explained that the value also depended on the provisioning rate on the outstanding volume of SDBO assets, where a variation of 0,1 % could alter the value by some FRF 20 million. The authorities concluded on that basis that there were no grounds for considering that the price of FRF 50 million was unusual.

(iv) Terms of payment

The French authorities made the following points concerning the use of CL preference shares as a means of payment in the transaction in question. First, the preference shares are securities without any voting rights and are thus not comparable to shares. CDR does not therefore become a CL shareholder, which maintains the necessary separation between CL and the hive-off vehicle. According to the French authorities, the CL preference shares used in this transaction could not, because of stock exchange regulations, be negotiated by CL itself, entitled only to carry out price adjustment operations on its own account. The CL preference shares were transferred at the stock exchange price on the day the contribution was made (28 June 1996). The French authorities also pointed out to the Commission by letter of 11 November 1996 that, from June to October 1996, CDR had been able to sell nearly all the CL preference shares on the stock exchange under satisfactory conditions, for a total of FRF 54 million, so that the end result of the share transactions resulted in a gain for CDR of FRF 6,66 million.

(v) Liquidation costs

In their letter of 11 November 1996, the French authorities repeated their argument that the cost of winding up SDBO, estimated by CDR at FRF 220 to 230 million, would have exceeded the net cost of the transaction borne by CDR, namely some FRF 190 million (that is, the cost of recapitalisation, FRF 240,5 million, minus the product...
of the sale, FRF 50 million). The French authorities pointed out that the CDR estimate of liquidation costs was based on an estimate by the bank advising CDR of costs totalling some FRF 180 to 190 million, to which CDR had added FRF 40 million, chiefly to cover social costs, as it considered the amount taken into account by CFER insufficient.

In their letter of 13 June 1997, the French authorities presented two fresh arguments concerning the liquidation costs which CDR would have borne. First, the authorities considered that Annex 16 to the Protocol of agreement of 5 April 1995 between CL and CDR provided for compensation by CDR for all companies of the CL group incurring future costs and consequences of civil, administrative, arbitration or other ongoing procedures relating to the assets and liabilities or commitments guaranteed by CDR, as defined in Annex 16.2.1. The French authorities informed the Commission of the opinion of their lawyers that the social plan negotiated within SDBO was covered by the words 'other ongoing procedures' and that the fact that the plan was not specifically referred to in the Annex in question did not alter that view, the terms defined in the Annex referring only to CDR liabilities and not assets. Secondly, the French authorities and their lawyers referred to recent Court of Appeal (Cour de Cassation) case-law stipulating that redundancies on economic grounds must be preceded by an effort on the part of the employer to find other employment within the group to which the firm belongs, failing which the redundancy becomes void. The French authorities concluded that they are justified on those grounds in including social costs, estimated at FRF 162 million, in the liquidation costs that would be borne by CDR. By letter of 13 June 1997 they revised the previous estimate of the total liquidation costs to be borne by CDR, arriving at a figure of FRF 350 million.

In view of the foregoing, the French authorities took the view that the sale of part of SDBO to CL did not constitute State aid.

V. ASSESSMENT OF THE AID

(i) Distortion of trade between Member States

Competition between financial establishments within the Community is growing as a result of economic and monetary union. With the creation of the single currency, trade in the Community will be able to develop without incurring risks or exchange costs, which will heighten the distortions of competition that had until then been limited to Member States’ domestic markets.

As the Commission pointed out in its notice initiating the procedure, aid that is designed to allow credit institutions to survive despite a lower level of profitability and capacity to meet competitive challenges, such as the aid to SDBO, is liable to distort competition in the Community when it makes it more difficult for foreign banks to enter the various domestic banking markets. Such is the case with the aid in question. It has been explicitly established that no foreign bank was contacted in connection with the disposal of SDBO and none was able to express an interest. Furthermore, by keeping an uncompetitive French business alive by means of the measures in question, financial institutions in other Community countries are deprived of an opportunity to expand their exports of financial services in France so as to reach the clientele of the SDBO branch being sold.

Furthermore, as it was decided to recapitalise part of the business rather than wind up the whole of SDBO, no banks in other Community countries were given the opportunity to acquire the assets, especially the sounder assets sold to CL which would have been put on the market in the event of liquidation.

Consequently, it must be concluded that if the measures in question contain aid, they are caught by Article 92(1) of the Treaty as they constitute State aid which distorts competition to an extent liable to affect trade between Member States.

(ii) Transfer procedure adopted for the healthy part of SDBO

The Commission set out its position on privatisation transactions in its 23rd Competition Report (1) for 1993, and listed cases where such a transaction could be regarded as not containing aid and those where notification would be required owing to a presumption of aid; the cases were also listed in its notice of 18 September 1996 on the initiation of this procedure. The principles provide in particular that there is no State aid and no need to notify if:

— an unconditional competitive tender is held,
— it takes place in non-discriminatory and transparent conditions,

(1) See paragraph 403, page 273. The French authorities had been informed beforehand about the Commission’s position by letter of 14 July 1993 from de Director-General for Competition.
— the company is sold to the highest bidder,
— bidders are given enough time and information to carry out a proper valuation of the assets as the basis of their bid.

On the other hand, the Commission considers that a sale must be notified in advance in accordance with Article 93(3) of the Treaty as it may contain State aid if it:

— takes place either after negotiation with the single prospective purchaser or a number of selected bidders (in that event, there may be aid to the purchaser if the price is not a market price and is under-valued (see (iii)(b)),
— or is preceded by the writing-off of debt by the State, other public enterprises or any public body, in which case the aid is granted to the firm receiving the capital injection,
— or is preceded by the conversion of debt into equity or capital increases, in which case the aid is granted to the firm receiving the capital injection (see (iii)(a) and (iv)),
— or takes place on conditions that are not customary in comparable transactions between investors in a market economy.

It seems that the transaction failed in several respects to follow the principles outlined above which could have exempted it from notification, as it was not the subject of an unconditional, transparent and non-discriminatory competitive tender and it was preceded by a capital increase.

The Commission considers in particular that, in two fundamental respects, the sale of the healthy part of SDBO did not satisfy the need for transparency and impartiality. First, the list of banks contacted in January 1996 by the bank advising CDR is limited to eight French institutions. The French authorities justified that on the grounds of the limited value of such an acquisition to French and European banking establishments and by the urgency in view of the deteriorating image of SDBO. The Commission, however, does not see that there is any justification for the preference given to French banks over other Community banks. It is not for the vendor to take the place of a potential buyer in order to decide in advance whether such an acquisition is in the latter’s interests. Only by consulting a far larger number of banks, including banks outside France, would it have been possible to check a posteriori the accuracy of the French authorities’ claim.

Secondly, basic information on the valuation of the business and the recapitalisation of the SDBO branch being sold was modified in the course of the transfer procedure. Only CL was able to benefit from the information on these changes. The other eight banks were not informed by CDR of the revised estimate made by its advisory bank at the beginning of 1996 of the value of the healthy part of SDBO or of the transfer of the obligation to recapitalise the firm from the buyer to the vendor, or of the change in the volume of assets sold by the authorities or, in fine, of the decision by CDR to increase the recapitalisation from FRF 207 million to FRF 240.5 million. As was confirmed by the comments received from Société Générale, none of the eight other banks was given the opportunity to modify their assessment and make an offer on the basis of the new information. By letters of 29 January and 13 June 1997, the French authorities denied that the banks were approached on the basis of recapitalisation at the expense of the buyer and considered that Société Générale could not claim that the invitation to tender would, if it had made an offer, have required it to provide the capital itself.

The Commission has checked this particular point. The assessment report prepared by the bank advising CDR served as a basic document to the invitation to tender and was sent to each of the eight banks in question. Chapter 6.1 ‘Valuation framework’ of the report states that the
valuation of the healthy part of SDBO, referred to as the sound bank, is based on its transfer from CDR to an establishment that will be responsible for its recapitalisation. [...] The valuation [...] will also take account of the fact that the capitalisation of the new establishment will be carried out by the beneficiary. It is thus very clear from this document that the banks approached were consulted on the basis of recapitalisation at the expense of the buyer. The Commission cannot therefore consider, as was claimed by CFER and the French authorities in a letter of 13 June 1997, that recapitalisation by the buyer was only a working hypothesis.

The Commission is not concerned with the desirability as such of recapitalising the relevant part of SDBO before or after a transfer which, in the latter case, would have been at a negative price: in both cases, the transaction should have been notified to it under Article 93 of the Treaty as it involved the transfer of CDR resources. On the other hand, as soon as one method is chosen rather than another, the vendor should keep to it throughout the procedure. These factors, together with the altered estimate of the value and the volume of the SDBO assets in the middle of a transfer procedure, introduce inequality between CL and the other potential buyers. Any change in the initial data supplied to the potential buyer should have given rise to a new invitation to tender. The procedure followed did not therefore guarantee the transfer of the healthy part of SDBO under the necessary conditions of impartiality and transparency.

On the basis of the abovementioned criteria which the Commission applies in cases of privatisation, the transaction should therefore have been notified to it as it was likely to include aid in view of the procedure adopted.

(iii) Measures covered by this procedure

(a) The recapitalisation

The recapitalisation measures in question concern the ‘healthy’ part of SDBO (the ‘sound’ bank) and not its less-performing assets which, like the legal entity SDBO, remained the property of CDR after the recapitalisation and sale of the ‘sound’ bank.

The capital injection is an extra cost borne by the State and is not provided for in the restructuring plans for CL approved by the Commission in its decisions of 26 July 1995 and 20 May 1998. As the French authorities pointed out, because the recapitalisation was chiefly intended to make good the negative value of the ‘sound’ bank to avoid a sale at a negative price, the losses incurred by CDR on the transaction are not related to the book value of the SDBO contribution to CDR in respect of which provisions or loss from transfer were made by CDR and included by the Commission in calculating the estimated aid (upper value within the range) to CL authorised in its decision of 20 May 1998 on CL. The aid in question (see below, confirmation that the transaction comprises aid) may thus differ in nature and amount from the aid to CL already authorised by the Commission.

(b) Possible aid to the buyer in the terms and price of the sale

In its notice of 18 September 1996 on the initiation of this procedure, the Commission considered that, in view of the transfer procedure adopted and the value of the firm as estimated at the time by the authorities, there was a presumption of aid to the buyer (CL), assuming that the price paid by the latter for the assets was lower than their value.

Following the extension of the procedure in April 1997, it would seem as matters stand that, in the absence of alternative offers from the other banks approached in January 1996 by the bank advising CDR, a transfer agreement was signed on 2 February 1996 by CDR and Credit Lyonnais on the acquisition of the healthy assets of SDBO by the latter at a price (FRF 50 million) which differed from the reference value fixed by the authorities (minus FRF 20,5 million after recapitalisation) for the healthy part of SDBO. The Commission is unable, owing to that difference and the procedure followed, to conclude that the selling price agreed on by the parties is a market price.

The Commission has noted the information sent by the French authorities by letter of 11 November 1996 on the revaluation of the healthy part of SDBO carried out at the beginning of 1996, based on a correction by the bank advising CDR of the expected results achieved by the SDBO branch being sold and the value of the bank obtained on the basis of discounted income flows, namely a negative value of FRF 220 million. The Commission notes, however, that the valuation method currently preferred by the French authorities is in contradiction with their original presentation of the transaction based on the weighted average of three valuations obtained by different methods.

Despite the inadequacies of the transfer procedure adopted, the Commission is prepared to accept the French authorities’ argument that the discounted cash flow method is an appropriate method of valuing the assets to be sold. The Commission generally takes the view that it is the standard method that should be preferred in transactions of this kind, as it values the firm
concerned with a view to its long-term prospects, usually the aim of any buyer. The bank advising CDR had already drawn the latter’s attention, in a letter dated 23 February 1996, to the downward revision of the expected results for 1996 and, given the repercussions of the revision on the forecast for subsequent years, stressed the impact on the value of the company determined using the discounted cash flow method. On that basis, the Commission can also accept the new estimated value presented by the French authorities, namely a negative value for the SDBO assets sold of minus FRF 220 million (before recapitalisation).

Given CDR’s decision to recapitalise the healthy part of SDBO at its own expense to the tune of FRF 240,5 million, the value of the part sold after recapitalisation is FRF 20,5 million, as the French authorities note in their letter to the Commission of 11 November 1996.

Accordingly, on the basis of the estimated value of the assets accepted by the French authorities and in view of the selling price of FRF 50 million, the Commission concludes that the transaction did not involve aid to the buyer.

It is pointed out, however, that the price at which the healthy part of SDBO (FRF 50 million) was sold to CL is in itself unusual and unjustified, inasmuch as it exceeded the value of the assets by FRF 29,5 million — an overvaluation by some 60 %. The French authorities endeavoured to justify that price in a letter of 13 June 1997 on the ground of a last-minute adjustment to the volume of assets sold and by the very wide range of valuations of the bank, ranging from FRF 3,8 million to FRF 45,4 million, depending on the valuation method used by CFER (namely stock-exchange comparison, revalued net assets and discounted cash-flow methods); they also provided data from CFER on the volatility of the estimate in relation to the provisions for loans of the 'sound' bank. The Commission notes that it is highly contradictory to consider, as the French authorities did in their letter of 11 November 1996, that the value of the bank should in fact be defined solely on the basis of the flow method, giving a value of FRF 20,5 million after recapitalisation (which resulted in the Commission's extending this procedure to take account of the change in the valuation method), and then later to consider that the selling price should be assessed again on the basis of a range comprising several methods. By imposing an additional cost, corresponding to the extra value, on CL, thus producing an improper transfer of value from CL to CDR, the transaction runs counter to the objectives of the CL restructuring plan. Nevertheless, a price that is higher than the value of the asset does not in itself constitute State aid, especially as the beneficiary of the extra value, CDR, is the holding company created to wind-up CL’s bad assets rather than a firm in competition with others.

(iv) Presence of State aid in the recapitalisation

As the Commission pointed out in its notice initiating the procedure, the recapitalisation in question may contain State aid pursuant to Article 92(1) of the Treaty. The recapitalisation, which represents a considerable investment by CDR, should have been notified to the Commission by the authorities before it was carried out by CDR. As the latter is a public undertaking, set up by the State as part of a plan to rescue CL, and is controlled by the public authorities, its resources are State resources within the meaning of Article 92(1) of the Treaty. Any injection of funds by CDR into one of its subsidiaries thus constitutes State aid if, under normal market conditions, a private investor would not have carried out a similar operation (1). If it is confirmed that a non-notified measure of this type constitutes State aid, it is unlawful. It is for the Commission to determine, if appropriate, whether such aid may be regarded as compatible with the Treaty.

The French authorities have not backed their claim that the measure does not constitute State aid with any information on returns on capital invested which would indicate that, under similar circumstances, a private investor would have been prepared to recapitalise the firm. On the contrary, the aid was essentially granted on a non-repayable basis, CDR having recouped only a very small fraction of the capital injected from the selling price. With the exception of Banque Delubac, which submitted a bid rejected by CDR as it did not cover a sufficient number of assets, the fact that all the banks contacted declined the invitation to acquire the 'healthy' part of SDBO, on the basis of the volume of assets defined by the vendor and recapitalisation at the buyer’s expense, lends credence to the argument that a private investor would not have invested the capital. Furthermore, the forecasts corrected at the beginning of 1996 by the bank advising CDR indicate that the firm incurred losses in 1996, 1997 and 1998, so that its estimated value using the discounted cash-flow method was very negative (FRF 220 million).

(1) In deciding whether injections of public resources into a firm constitute State aid, the commission applies the principle of a commercial investment in a market economy, see communication to the Member States (OJ C 307, 13.11.1993, p. 3).
The Commission noted the argument put forward by the French authorities by letter of 11 November 1996 that, if the transferable assets of the firm had been wound up, CDR would have incurred costs of some FRF 220 million to 230 million. The recapitalisation (FRF 240.5 million) followed by the sale (FRF 50 million) resulted in net costs (FRF 190 million). In the letter of 13 June 1997 the French authorities also re-estimated at FRF 350 million the total costs of winding up the transferable assets of SDBO, including the liquidation costs for loans outstanding (FRF 180 to 190 million) and social costs (some FRF 160 million). They conclude on this basis that CDR acted as a prudent shareholder and that the recapitalisation measures in question do not constitute aid.

The Commission cannot agree that the liquidation costs referred to by the French authorities are chargeable to the shareholder. The estimated liquidation costs to be borne by the shareholder are based on the assumption that CDR, which owned SDBO, would be required to make good the liabilities in the event of liquidation and was liable for various liquidation charges such as the social costs. In similar precedents, the Commission and the Court of Justice of the European Communities have consistently rejected (1) the argument that such costs are chargeable to the shareholder, on the ground that a shareholder’s liability is related to the value of its contribution to the firm’s capital and not to all the liquidation debts. The fact that the State (or a public entity such as CDR) takes over all or part of the liquidation debts is not due to its status as a shareholder but to additional obligations which it considers are placed on it and which take the form of aid. Accordingly, in calculating the liquidation costs, the Commission can take account only of those costs that are chargeable to the shareholder State, that is, usually the amount of its contribution to the firm’s capital.

The Commission has in particular examined the provisions of the law of 25 January 1985 on company rehabilitation and liquidation (2). The law cannot be invoked to establish a shareholder’s liability for all the liquidation debts. Article 180 of the law provides that, in the event of liquidation charges such as the social costs of liquidation would have been borne by CDR when the Protocol of Agreement between CL and CDR was signed. The recapitalisation (FRF 240.5 million) was followed by the sale (FRF 50 million) resulting in net costs (FRF 190 million). In the letter of 13 June 1997 the French authorities also re-estimated at FRF 350 million the total costs of winding up the transferable assets of SDBO, including the liquidation costs for loans outstanding (FRF 180 to 190 million) and social costs (some FRF 160 million). They conclude on this basis that CDR acted as a prudent shareholder and that the recapitalisation measures in question do not constitute aid.

Neither the French authorities nor the present procedure have produced evidence that CDR is equivalent to an ipso jure or de facto manager of SDBO following the latter’s hiving-off to CDR in 1995, or that it committed errors of management which justify requiring it to make good all or part of the liquidation debts of SDBO.

In their letter of 13 June 1997 the French authorities pointed out that Annex 16.2 to the Protocol of 5 April 1995 between CL and CDR provides for CDR to compensate any CL company for possible future costs and consequences of civil, administrative, arbitration or other ongoing proceedings connected with assets, liabilities or commitments guaranteed by CDR, as defined in Annex 16.2.1. The authorities concluded from this that, in the event of liquidation owing to the cessation of the activities which formed the basis for the social plan of 1995, negotiated before SDBO was hived-off to CDR, the latter should have borne the cost of compensating the workforce for the termination of the social plan. The Commission notes, however, that Annex 16.2.1. refers only to transferred assets and not to any social commitments. Furthermore, the event to which the French authorities refer is a liquidation which, when the Protocol was drawn up, was not an ongoing proceeding. The Commission cannot therefore agree with the French authorities on this point or with the views of the lawyers contained in the same letter, to the effect that the social costs of liquidation would have been borne by CDR under the Protocol of Agreement between CL and CDR.

In support of their argument that CDR would bear all or part of the social costs of winding up SDBO, the French authorities referred in the same letter of 13 June 1997 to a recent judgment of the French Court of Appeal (Cour de Cassation) (3), stating that redundancy for

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(3) Judgments of the Court of Appeal of 5 April 1995 and 3 February 1996.
economical reasons must be preceded by a search for other possible employment within the group to which the employer belongs, failing which the redundancy procedure would become void. However, the obligation in question clearly relates to the search and not to the result. To the extent that CDR (the ‘group’ to which SDBO belongs) has the task of selling or liquidating the poor-quality assets hived-off to it, and having regard to the mix of activities hived-off, most of which have nothing in common with the banking activities of SDBO, it is unlikely that, if SDBO had been liquidated, there would have been any significant chance of re-employing SDBO staff in the firms hived-off to CDR. Lastly, the French authorities appear to draw an arguable parallel between the obligation of the employer (SDBO) and that of the shareholder (CDR): according to the abovementioned case-law of the Court of Appeal, as presented by the authorities’ legal representatives, a redundancy procedure initiated by an employer (SDBO) becomes null and void under certain circumstances (failure to seek alternative employment within the group), but clearly does not impose such a requirement or compensatory payments by the employer, on the shareholder (CDR).

The Commission cannot therefore accept the estimated liquidation costs borne by the shareholder as presented by the French authorities. It is not apparent that CDR chose the least costly option by deciding to recapitalise and sell SDBO, under the conditions described above. Furthermore, on a secondary basis, even if that were the case as a result of management errors by CDR as the ipso facto or de facto manager, the Commission notes that the provisions of the 1985 law would not enable the French State to claim exemption from Article 92 of the Treaty without flouting the principle of law that arguments cannot be based on one’s own faults.

As a result, the private investor would not, on the basis of the foregoing, have carried out the recapitalisation which, as it is liable to affect intra-Community trade, thus constitutes a measure containing aid within the meaning of Article 92(1) of the Treaty. As stated in the Commission notice initiating this procedure, the compatibility of such a measure with the common market can be examined only pursuant to Article 92(3)(c) of the Treaty, on the basis of a new restructuring plan which, in particular, demonstrates that the firm is viable.

(v) Assessment of the compatibility of aid granted in the form of capital injections

As the Court of Justice of the European Communities has consistently held, aid must be assessed on the basis of its effects. In the present case, the effects of the measures concerned, borne by CDR, must be assessed from the standpoint of the ‘sound’ bank.

In assessing the compatibility of the aid in question, the Commission follows the general principles contained in its guidelines on rescue and restructuring aid (1) which sets out the conditions for such aid to be regarded as compatible with the Treaty. Because the measures do not constitute rescue aid within the meaning of the guidelines, as they are not temporary pending other restructuring measures, their compatibility with the Treaty must be determined by examining whether they may be regarded as restructuring aid and, if appropriate, whether they satisfy the conditions applicable to restructuring aid. In particular, the restructuring plan must restore the viability of the enterprise. Furthermore, in order to be compatible with the Treaty, the measures must not cause distortions of competition contrary to the common interest, the aid must be in proportion to the costs and benefits of restructuring and the plan must be implemented in full.

The authorities have not presented the Commission with any overall restructuring plan for SDBO, although some of its assets were clearly impossible to manage so as to yield a satisfactory rate of return. CDR, however undertook restructuring measures aimed at isolating and reselling to CL the part of SDBO regarded as healthy — the ‘sound’ bank. The less-performing assets continued to be managed firms in difficulty (OJ C 368, 23.12.1994, p. 12).

The Commission therefore concludes that it cannot accept the estimated liquidation costs borne by the shareholder as presented by the French authorities. It notes in particular that the obligations of the employer (SDBO) and that of the shareholder (CDR) under the law of 1985 on company rehabilitation and liquidation has not been proved either, and must be rejected by the Commission.

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The measures in question were as follows:

— withdrawal from the property business, already commenced in 1993 — the year in which most SDBO property assets were hived off to the CL property vehicle (Omnium Immobilier de Gestion, subsequently integrated in 1995 in CDR for FRF 44 billion of debt),

— refocusing of the bank’s activities on the legal professions, commercial banking services for SMEs, financial engineering, asset management for third parties and market activities,

— the social plan for June to the end of August 1995, involving a substantial reduction in the workforce from 372 to 242 employees,

— an improvement in audit procedures in 1995, including the setting-up of an internal audit team and reinforced management control,

— internal reorganisation of the bank on the basis of two main departments with responsibility for operational matters (law courts department, commercial department, private management, merchant banking), production and logistics.

The Commission notes that these measures, which were already operative in 1995 (and in 1993 as regards the withdrawal from the property market), could not be regarded in 1996 as constituting, at the time of the capital increase in the second quarter, a restructuring plan enabling the fresh aid to be regarded as compatible with the common market.

Apart from the regrouping and reorganisation measures, a commercial plan was approved in 1995 designed to place the ‘sound’ bank on a healthy footing. The commercial plan, intended to stabilise a turnover rate that had steadily declined in preceding years, was aimed at ensuring that the business remained in strict equilibrium.

The hypothetical results were, however, dependent on the amount of capital that would subsequently be injected into the transferred branch of SDBO, a figure not known when the forecasts were drawn up at the end of 1995. Initially estimated by CFER at FRF 207 million, the recapitalisation would, according to the bank advising CDR, have had the effect of producing a net operating result of FRF 45 million and a result of FRF 9,6 million. If the forecasts had been realised, it would have been possible to envisage the viability of the healthy part of SDBO, although that is not certain since not only was the return on capital insufficient to attract risk capital but also the firm’s result, very close to equilibrium, was particularly vulnerable to any unforeseen hazards. An operating result that was higher by FRF 13 million (1) following a capital injection of FRF 207 million, the figure proposed at the time, would have produced, on the basis of forecasts made at the end of 1995, a corrected net result of FRF 15 million in 1998, which still represents a very low rate of return.

### Table 2

**Projections for the commercial plan drawn up at the end of 1995**

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross margin</td>
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<td>190</td>
<td>195</td>
</tr>
<tr>
<td>Gross operating result</td>
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<td>32</td>
<td>37</td>
</tr>
<tr>
<td>Net result</td>
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</tr>
<tr>
<td>Profitability</td>
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<td>na</td>
<td>na</td>
</tr>
</tbody>
</table>

(1) 1996 budget hypothesis  
Source: CFER

The figures (see Table 2), however, which were provisional when the forecasts were drawn up at the end of 1995, were already irrelevant when the transfer took place in 1996. According to information provided by the French authorities by letter of 11 November 1996, at the beginning of 1996 the bank advising CDR corrected its 1996 estimate of the expected result for SDBO by FRF 16 million downwards and applied a similar negative correction to the subsequent years. On the basis of that correction, the ‘sound’ bank would have incurred losses in 1996, 1997 and 1998. As a result, using the discounted cashflow method, the advisory bank produced a very negative estimate of the value of the company. As a result, at the end of the transaction, the recapitalised entity could not be regarded as viable.

Thus the first requirement, according to the abovementioned guidelines, for aid to be regarded as compatible has not been satisfied. The commercial recovery plan contained in the CFER document submitted by the French authorities to the Commission cannot be accepted by the latter as it has been established that, during the transaction in question, it did not allow the firm to become viable. As the aid granted to the assets sold was not intended to accompany a plan capable of restoring viability, it cannot be regarded as restructuring aid but as de facto operating aid. The plan therefore does not satisfy the requirements of the guidelines.

(1) FRF 207 million multiplied by an average long-term interest rate of 6,5% in 1996.
As it distorts competition to an extent which may affect intra-Community trade (see Section V(i)), the recapitalisation comprises elements of State aid pursuant to Article 92(1) of the Treaty and, as it was not notified, it is therefore unlawful. In view of the fact that, as was established by the Commission in its notice initiating the procedure, its compatibility with the Treaty could be assessed only pursuant to Article 92(3)(c) of the Treaty on the basis of a new restructuring plan demonstrating, in particular, the viability of the firm, it must be concluded in view of the foregoing that the recapitalisation of the healthy part of SDBO constitutes aid that is incompatible with the common market and unlawful as it was implemented without being notified.

(vi) Mode of payment by the buyer

Taking note of the information supplied by the French authorities and outlined in Section IV, the Commission considers that payment in the form of CL preference shares rather than payment in cash for SDBO was inappropriate. In any such transaction, all payments in the form of listed securities, the value of which is volatile, may give rise to aid where the State sells some of its assets in exchange for the buyer's securities. Furthermore, the fact that CDR held CL securities, even temporarily, is contrary to the need for strict separation between the hive-off vehicle and CL pursuant to Decision 95/547/EEC. Any decline in the value of CL would be reflected in the value of the preference shares held by CDR.

As the Commission has not been informed of any factors offsetting the risk incurred by CDR in connection with this method of payment, it is highly unlikely that, before the completion of this transaction, a private shareholder would have agreed to sell its assets in exchange for volatile securities. There was a considerable risk of incurring a loss, as the poor results of the bank produced the safeguard measures notified to the Commission in September; the risk should have been avoided, particularly in view of the volatility of the preference share rate, which fell by some 50% between 31 December 1995 and June 1996. The Commission, which analysed the transaction on the basis of the conditions known on the date of the transaction (and not on the basis of the *ex post* gain made by CDR on the securities), considered that a private operator would, in view of such volatile securities as the CL preference shares which had fallen by almost 50% in the month preceding the transaction, have demanded a discount on the stock exchange rate in order to take account of that risk. It therefore considers that the transaction gives rise to aid in respect of the discount which a private investor would have required. It is particularly difficult, however, to assess the amount of aid. In view of the extra value of FRF 29.5 million which CL paid for the 'sound' bank — about 60% of the amount of the transaction — the Commission considers that this element of aid to CL cannot exceed the extra value of 60% in question and that it should not therefore be included in the calculation of aid covered by this Decision.

VI. CONCLUSIONS

Concluding the procedure initiated on 18 September 1996 and extended on 2 April 1997 concerning the recapitalisation and transfer of part of SDBO to CL, the Commission has reached the following conclusion:

1. The procedure for the transfer of the healthy part of SDBO failed to apply the equality of treatment that is desirable between, on the one hand, the eight pre-selected potential buyers and, on the other, CL. Having taken place without an open and unconditional invitation to tender, it should have been notified to the Commission under the criteria defined in the 23rd Competition Report. In particular, it did not allow the banks of other Community countries to submit bids and consequently distorted competition in the Community to an extent liable to affect trade between the Member States. The price paid for the transfer of the healthy assets of SDBO — FRF 50 million — is an excessive purchase price, to the detriment of CL as regards the FRF 29.5 million in extra value paid by CL. In view of the selling price and extra value paid by CL, the Commission concludes that the transaction did not involve State aid to the purchaser, which would have been the case, as stated when this procedure was initiated, if the selling price had been too low in relation to the real value of the assets sold.

2. The recapitalisation of the SDBO assets sold to CL increased CDR's losses and caused the hive-off mechanism to exceed the costs approved by the Commission in Decisions 95/547/EC and 98/490/EC on CL. However, the additional losses borne by the hive-off are not chargeable to CL in the same way as provisions for asset depreciation which occurred during the transfer of the CL assets or subsequently during the hiving-off: the cause of the losses is not the hive-off operation but a management decision, for which CDR alone is responsible, taken after the transfer of the assets in question from CL to CDR. It should
be noted that, although CDR continues to be wholly-owned by CL, it is not consolidated and is not involved in any of the management or supervisory bodies of CDR. The nature of the aid and its recipient are different from the aid to CL. As a result, the recapitalisation of SDBO is a measure intended to assist the ‘sound’ bank sold immediately after the transaction and not CL as part of the overall hive-off operation.

3. The recapitalisation of FRF 240.5 million prior to the disposal of the healthy part of SDBO, which had a negative value and could have been wound up at less cost to the shareholder, constitutes State aid to the recapitalised entity because a private investor would not have invested such capital under similar circumstances. As the recapitalisation was not notified to the Commission, it is unlawful. Furthermore, it was not accompanied by a restructuring plan demonstrating the viability of the firm, with the result that the exemption provided for in Article 92(3)(c) of the Treaty which was, as stated in the notice initiating this procedure, the only possible exemption under the circumstances, is not applicable. The aid in question is therefore not compatible with the Treaty.

4. The terms of payment for the sale of the healthy part of SDBO in the form of CL preference shares are not appropriate to such a transaction, in particular because the parties to the contract have unequal information with a view to determining their value. They are also contrary to the necessary separation between CDR and CL. They constitute aid to CL amounting to the value of the discount on the securities which a private vendor, remunerated in this way, would have required at the end of the transaction. However, in view of the extra value of FRF 29.5 million paid by CL, the Commission takes the view that the discount should not exceed that amount, namely about 60% of the selling price, and that CL did not benefit from any aid in the transaction in question.

5. The Commission concludes that State aid was granted through the measures covered by the procedure initiated on 18 September 1996 in the form of the recapitalisation by CDR of the SDBO assets sold to CL for FRF 240.5 million. The Commission cannot deduct the product of the sale (FRF 50 million) from that amount, as the funds paid by CL also constitute State resources within the meaning of Article 92(1) of the Treaty and do not reduce the amount of State resources employed in this transaction. The aid granted by CDR in the context of the transaction amounts to a total FRF 240.5 million.

HAS ADOPTED THIS DECISION:

1. Article 1
The capital increase of FRF 240.5 million granted by the French State through CDR to SDBO before the transfer of its healthy activities to CL constitutes State aid within the meaning of Article 92(1) of the Treaty and Article 61(1) of the EEA Agreement. The aid is unlawful and is incompatible with the common market within the meaning of Article 92(2) and (3) of the Treaty and Article 61(2) and (3) of the EEA Agreement.

2. Article 2
France shall take steps to recover the full amount of FRF 240.5 million constituting the State aid in question. The amount to be repaid shall bear interest from the date on which the aid was granted, at the reference rate established by the Commission for the calculation of the net grant equivalent of aid in France.

3. Article 3
The French Government shall inform the Commission within two months of the date of notification of this Decision of the measures it has taken to comply herewith.

4. Article 4
This Decision is addressed to the French Republic.


For the Commission
Karel VAN MIERT
Member of the Commission