II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 14 October 1998

conditionally approving aid granted by France to Société Marseillaise de Crédit

(notified under document number C(1998) 3210)

(Only the French text is authentic)

(Text with EEA relevance)

(1999/508/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having given the parties concerned the opportunity to submit their comments, in accordance with the abovementioned Articles,

Whereas:

1. INTRODUCTION

In July 1993 the French authorities informed the Commission that between August 1993 and the beginning of 1994 Société Marseillaise de Crédit (SMC), a bank in which the French State was the sole shareholder, was to receive a capital injection from the State amounting to some FRF 860 million, in two instalments.

After examining the case on the basis of the information provided by the French authorities, including the restructuring plan for the bank, the Commission concluded that no State aid was involved (letter of 13 October 1993, D/9462).

By letter of 3 October 1996 the Commission notified the French authorities that on 18 September it had decided to initiate proceedings under Article 93(2) of the Treaty in respect of other State measures in support of SMC(1). The Commission took the view that the following measures might contain State aid components caught by Article 92(1) of the Treaty: (i) capital increases totalling FRF 1 241 million in 1994 and 1995; and (ii) a projected capital increase of FRF 858 million in 1996.

The Commission also said that it might re-examine the capital increases which had been notified in 1993, totalling FRF 860 million, if the information assembled in the course of the proceedings it was now initiating showed that the assessment which it had made in 1993 was based on incorrect information, or if there had been material changes in the circumstances which had led it to form a favourable opinion of the aid.

By letter of 23 July 1998 the Commission informed the French authorities that on 14 July it had decided to extend the Article 93(2) proceedings to include a fresh injection of capital into SMC amounting to FRF 2 909 million, and a guarantee to cover possible claims of up to about FRF 400 million(2).

(2) OJ C 249, 8.8.1998, p. 11.
2. DESCRIPTION OF THE MEASURES

2.1. Background

SMC has been a publicly-owned bank since its nationalisation in 1982. Its legal form is that of a public limited company governed by the Law of 24 July 1966 on commercial companies, the Nationalisation Law of 11 February 1982, and the Banking Law of 24 January 1984. It is also subject to the Law of 26 July 1983 on public-sector democratisation: its board is made up of five representatives of the State, five employee representatives elected by the staff, and five government-appointed figures selected for their expertise. As a deposit bank its object is to carry out banking, financial and commission-based operations of all kinds both inside and outside France. It operates mainly in the south of France, where its clientele is made up principally of small and medium-sized enterprises operating in the region, traders, and private individuals. Large companies established in the south and real estate firms are also important customers.

The bank has 156 branches in the south and altogether six offices in Paris. It has a number of specialised subsidiaries in banking-related areas, such as property financing. It has no foreign subsidiaries.

At the end of 1997 its balance-sheet total was about FRF 23 000 million. It had a total of 2 054 employees at that time.

SMC was profitable up to 1990, though at a low and decreasing level: from 1987 to 1990, its profitability, expressed as the ratio between net profits and consolidated own funds, fell from 5% to 1%. In the 1990s SMC entered the property financing market, both on its own account and often with insufficient selectivity and risk assessment, embarked on too rapidly just before the property market fell, and regulatory constraints to which it was subject (4).

The loss in 1994, which was almost equal to total own funds, was due to the magnitude of allocations to provisions requested by the French banking supervisory authority, the Commission Bancaire, following an inquiry which it had carried out into SMC (3). In 1995 SMC recorded a consolidated loss of FRF 952 million. This was linked to FRF 330 million in provisions for real-estate subsidiaries, to which must be added FRF 400 million in provisions for bad or doubtful debts (including FRF 80 million in respect of real estate). According to the French authorities, such provisions were due to the continuing economic crisis in 1995, which was particularly serious in the south, and to SMC's continuing failure to monitor commitments sufficiently. In addition, operating costs remained too high as compared with those of competitors.

Despite the financial reorganisation carried out in 1994 and 1995, SMC has continued to record losses. Its results for 1996 are once again weighed down with a heavy burden of provisions. Substantial provisions had to be set aside for doubtful debts, including claims on customers, leasing operations, and losses on property claims. Excluding subsidiaries, total allocations to provisions and write-downs on doubtful claims on customers and in respect of leased property came to FRF 246 million; of this figure, claims on property developers accounted for FRF 48 million, and other loans and advances to customers for FRF 198 million.

Despite the effort at retrenchment, reflected in the sell-off of non-strategic assets, better selection of customers, and a reduction in charges, SMC did not succeed in balancing its accounts in the first half of 1997, when it made a consolidated loss of FRF 1.8 million. New management was appointed in December 1997, with a brief to put forward proposals to ensure the bank's future, and it proceeded to analyse this result exhaustively. Audits were carried out by independent consultants; it became clear that the further provisions required would exceed the bank's remaining own funds, and would place it in a position incompatible with the prudential and regulatory constraints to which it was subject (4).

As from 1991 SMC began to register losses, which have today reached a total of FRF 6 110 million (1991: FRF 11 million; 1992: FRF 451 million; 1993: FRF 317 million; 1994: FRF 1 257 million; 1995: FRF 952 million; 1996: FRF 22 million; 1997: FRF 3 100 million). The State as shareholder has thus had to recapitalise SMC on several occasions so as to enable it to comply with the European solvency requirements for banks.

The loss in 1994, which was almost equal to total own funds, was due to the magnitude of allocations to provisions requested by the French banking supervisory authority, the Commission Bancaire, following an inquiry which it had carried out into SMC (3).
In those circumstances, SMC’s shareholder took the view that the only way to ensure that SMC had a future was to recapitalise it and to associate it with a partner capable of successfully completing its restructuring. The process of selling off SMC was set in motion on 22 April 1998, when a notice was published in the Journal officiel de la République française announcing that it would be sold by private treaty without any conditions being attached. 16 banks were contacted, four were allowed to inspect the documentation, and just one, Banque Chaix, made a firm offer. Banque Chaix is a subsidiary of Crédit Commercial de France, a private French banking group which owns a nationwide network of retail branches and a number of regional banks; on 12 June 1998 Banque Chaix signed the contract for the purchase of the shares in SMC. On the same day SMC’s board approved the accounts for 1997, showing a consolidated loss of FRF 3,100 million, which meant that fresh capital of FRF 2,909 million was needed in order to reconstitute the minimum own funds required by the prudential rules. Before transferring ownership, the State decided to inject FRF 2,909 million by way of final recapitalisation of the bank, and to give the buyer an additional guarantee of up to FRF 423 million.

### Table 1

**SMC: main financial indicators**

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<tr>
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<tbody>
<tr>
<td>Overall operating income</td>
<td>1,240</td>
<td>1,353</td>
<td>1,023</td>
<td>977</td>
<td>1,442</td>
<td>1,211</td>
</tr>
<tr>
<td>Overheads and depreciation</td>
<td>1,344</td>
<td>1,334</td>
<td>1,262</td>
<td>1,204</td>
<td>1,170</td>
<td>1,158</td>
</tr>
<tr>
<td>Gross operating profit or loss</td>
<td>-104</td>
<td>18</td>
<td>-239</td>
<td>-228</td>
<td>272</td>
<td>53</td>
</tr>
<tr>
<td>Net profit or loss</td>
<td>-451</td>
<td>-317</td>
<td>-1,257</td>
<td>-952</td>
<td>-22</td>
<td>-3,100</td>
</tr>
<tr>
<td>Balance-sheet total</td>
<td>27,587</td>
<td>26,100</td>
<td>26,812</td>
<td>25,634</td>
<td>23,860</td>
<td>23,149</td>
</tr>
<tr>
<td>Equity capital</td>
<td>1,106</td>
<td>1,300 ($)^{(1)}</td>
<td>2,147 ($)^{(1)}</td>
<td>1,755 ($)^{(1)}</td>
<td>835</td>
<td>797</td>
</tr>
</tbody>
</table>

($)^{(1)}$ Including capital injections in 1993, 1994 and 1995.

Source: SMC annual reports 1992 to 1997

2.2. **Grounds for initiating and later extending the proceedings**

When it decided to initiate proceedings, on 18 September 1996, the Commission took the view that there might be elements of State aid within the meaning of Article 92(3) of the Treaty, in the capital increases in 1994 and 1995, totalling FRF 1,241 million (both operations being entered in the accounts for 1994), and the projected capital increase of FRF 858 million in 1996.

The Commission pointed out that these capital injections, which between them amounted to FRF 2,099 million, had become necessary to SMC’s survival because the recovery plan drawn up in 1993 had failed. There was no restructuring plan available which would return the company to long-term viability within a reasonable time. It had not been shown that a controlled liquidation would have been more costly than recapitalisation, as the French authorities believed. Nor had it been shown that the aid was proportionate and confined to the minimum strictly necessary.

Lastly, although the Commission had approved the FRF 860 million in fresh capital notified in 1993, it had to check whether its assessment had been based on incorrect information, or whether there had been any material changes in circumstances that might affect its previous assessment. In either case the FRF 860 million notified in 1993 might also be considered State aid.

It was for the same reasons that the Commission decided on 14 July 1998 that the new measures to assist SMC, consisting of a capital injection of FRF 2,909 million and an additional guarantee of some FRF 400 million, might likewise contain elements of State aid. In the course of the proceedings the Commission also wished to check whether the terms of the privatisation procedure might involve aid to SMC, and...
whether, in the light of the privatisation procedure followed, the selling price might involve aid to the buyer.

3. OBSERVATIONS SUBMITTED BY INTERESTED PARTIES

In response to the notice announcing the decision to initiate proceedings which was published in the *Official Journal of the European Communities*, the Commission received the following observations.

Société Générale, in a letter of 25 February 1997, comments specifically on the Commission’s view regarding the costs which the State would have to bear in its capacity as shareholder in the event that SMC were to be wound up. Société Générale argues that the principle of the limited liability of a shareholder does not apply to the main shareholder in a bank, who has an added responsibility to safeguard the confidence of depositors and markets. Société Générale cites the first paragraph of Article 52 of the French Banking Law of 24 January 1984, which requires the Governor of the Banque de France to ask the shareholders in an ailing bank to provide the support it needs. According to Société Générale, ‘in the event of difficulty a majority shareholder clearly cannot evade the obligation to guarantee the outstanding liabilities of a bank’.

The AFB, in a letter of 5 March 1997, supports Société Générale’s view, arguing in particular that the principle of limited liability is tempered very substantially by the aforementioned first paragraph of Article 52 of the Banking Law. If it were accepted that the shareholder was liable only to the extent of his shareholding, the preventive and reorganisational measures taken in respect of credit institutions would be deprived of the essential part of their effectiveness; this could lead to failures and compulsory windings up, which would not be conducive to creditor confidence or to the sound operation of the economy (7).

Following the extension of the proceedings decided on 14 July 1997 the Commission received no observations from interested third parties.

4. OBSERVATIONS SUBMITTED BY THE FRENCH AUTHORITIES

The French authorities sent the Commission observations defending the measures at issue by letter of 3 December 1996. They supplemented these observations in letters dated 7, 16 and 21 April, 26 August, and 10 December 1997, and 19 and 25 June 1998. In response to these letters the Commission extended the proceedings, and the French authorities then put forward further observations in letters dated 28 July, 12 August and 11 September 1998.

4.1. The capital injections

In their letter of 3 December 1996 the French authorities stated that the recovery plan for SMC notified in July 1993 had been complied with in all essentials, in particular with respect to the reduction of staff costs. SMC’s poor results in 1994 could be attributed to a slower than anticipated increase in net receipts from banking, and an increase, rather than the hoped-for reduction, in provisions and in the cost of bad debts.

In their letter of 26 August 1997 the French authorities stated that the injections of capital into SMC by the State apparently had not distorted or threatened to distort competition. SMC had not applied a pricing policy which distorted competition between banks: its rates on loans to customers were higher than those offered by its competitors, and its charges for services were at, or above, the average for banks in the same area. SMC had not strengthened its competitive position at the expense of other banks: since 1994 there had been a slow erosion of its market share and a stagnation in the number of its customers.

In their letters of 10 December 1997 and 18 and 25 June 1998 the French authorities stated that despite the effort at retrenchment, reflected in the sell-off of non-strategic assets, better selection of customers, and a reduction in charges, SMC had not succeeded in balancing its accounts in the first half of 1997. Following in-depth analysis and exhaustive audits carried out by the new management and by independent consultants, the French authorities concluded that the only solution capable of ensuring SMC’s future was to associate it with a partner with the know-how needed to complete its reorganisation. The authorities took the view that the decision to recapitalise SMC for the last time, by injecting FRF 2.9 billion and providing a guarantee of some FRF 400 million, would allow the bank to be sold to a private buyer prepared to restructure it.

4.2. Costs of winding up

In the course of the proceedings and by letter of 16 April 1997 the French authorities and the AFB supported Société Générale’s position, arguing in particular that there were three

(7) The Governor of the Banque de France also sent a letter, at the beginning of August 1997, which was outside the time properly allowed in these proceedings.
legislative provisions which substantially qualified the principle of the limited liability of a shareholder in a bank: the first paragraph of Article 52 of the Banking Law, already referred to, Article 180 of the Law of 25 January 1985 on company recovery and compulsory winding up, under which directors in law or in fact who have mismanaged a company may be required to make good all or part of its liabilities, and Article 1382 of the Civil Code, under which a person who by a wrongful act causes injury to another person is liable for that injury (8).

In their letter of 21 April 1997 the French authorities supplied a valuation of the costs of a voluntary winding up. They stated that if instead of injecting fresh capital the State had decided to wind SMC up on a voluntary basis at the beginning of 1995, the cost of the liquidation would have been around FRF 4.7 billion.

5. ASSESSMENT OF THE AID MEASURES

5.1. Distortion of trade between Member States

The liberalisation of financial services and the development of the common market in such services are making trade between Member States more and more sensitive to distortion of competition. In principle, banks carry on their business, based mainly on the taking of deposits and the granting of loans, without regard to frontiers, but in fact they do encounter obstacles to expansion abroad (9). These obstacles are frequently due to the roots that domestic banks have in their own areas, which make entry to the market more expensive for foreign banks. Liberalisation of capital movements will make it easier for banks to offer their services in other Member States, as Crédit Lyonnais, Deutsche Bank and Westdeutsche Landesbank have done, for example; and any aid given to a local bank will obstruct this development.

Competition between financial institutions in different Member States is growing more intense against the background of economic and monetary union. With the creation of the single currency, trade will be able to develop within the Community free of exchange risks and exchange costs, and this will render more acute the distortion of competition caused by State aid, which in the past was more likely to be confined to the domestic market of the particular Member State.

Aid measures like the measures to assist SMC, designed to permit the survival of a domestic credit institution which operates on a regional basis and which is suffering from insufficient profitability and from an incapacity to meet competitive challenges, are consequently liable to distort competition in the Community, because they make it more difficult for foreign banks to enter the French regional banking markets.

If the measures do contain an aid component, therefore, it must be concluded that they are caught by Article 92(1) of the Treaty, because they constitute State aid which distorts competition in a manner liable to affect trade between Member States.

5.2. Do the measures constitute aid?

5.2.1. The procedure for the sale of SMC

When it extended the present proceedings, on 14 July 1998, the Commission said it would have to check whether the terms of the privatisation procedure that had been followed might involve aid to SMC or to the buyer.

In its Twenty-third report on competition policy, covering the year 1993, the Commission set out its position on privatisation, indicating when it might consider that a privatisation did not involve State aid and when the privatisation procedure to be followed could be presumed to include a State aid component, so that the measure would have to be notified (10). According to these principles there is no State aid, and no notification is necessary, if the following conditions are met:

— an unconditional competitive tender is held,

— the tender is open to all comers and transparent,

— the company is sold to the highest bidder, and

— bidders are given enough time and information to carry out a proper valuation of the assets as the basis for their bid.

(8) See footnote 7.
(9) The entry of foreign banks into the French market is a relatively recent phenomenon; they reached 8% of the whole in 1993, but fell back to 7.7% in 1994.
(10) Point 403, p. 255. The Director-General for Competition had already informed the French authorities of the Commission's position, by letter of 14 July 1993.
On the other hand, a transfer may entail elements of State aid in the following cases:

— sale after negotiation with a single prospective purchaser, or a number of selected bidders, in which case there may be aid to the buyer if the price is not a market price and is underestimated,

— sale preceded by the writing-off of debt by the State, another public enterprise or any public body, in which case there is aid to the enterprise receiving the injection of capital,

— sale preceded by the conversion of debt into equity or by capital increases, in which case aid is likewise given to the enterprise receiving the injection of capital, and

— sale on conditions that are not customary in comparable transactions between private investors in a market economy.

In SMC's case, it appears at first sight that the sale might involve aid both to the buyer and to SMC, because the company is being sold by private treaty and because the sale was preceded by an increase in capital; but a more thorough examination of the procedure followed shows that it did provide the necessary transparency and impartiality.

The French Minister in charge, Mr Strauss-Kahn, issued a press release announcing the sale on 21 April 1998, and on 22 April a notice appeared in the Journal officiel de la République française stating that SMC would be sold by private treaty without any special conditions attached; the bank acting as consultant to the Treasury, Lazard Frères et Compagnie, then contacted 16 banks, both French and foreign, namely ABN AMRO; Argentaria, Spain; Banco de Santander, Spain; Banque Chaix; Banque Nationale de Paris; BBV, Spain; BCH, Spain; Caisse d'Épargne Provence-Alpes-Corse; Carron & Cie (Korkmaz Yigit Holding, Turkey); Cie Financière Edmond de Rothschild; Crédit Agricole; Crédit Mutuel; Groupe Banques Populaires; La Caixa, Spain; San Paolo, Italy; and SG. Four of these asked to inspect the documentation: Banque Chaix, Banque Nationale de Paris, Caisse d'Épargne Provence-Alpes-Corse, and SG. Only Banque Chaix made a firm offer to buy SMC, on 3 June 1998.

Of the banks contacted all those that manifested an interest in acquiring SMC were informed that before the handover, and after allowance for the consolidated net profit or loss for 1997, SMC would be recapitalised so as to comply with the European prudential and solvency ratios. The banks permitted to inspect the documentation were given a draft contract for the sale of SMC, which showed the figure for the recapitalisation and asked the prospective buyer to state what guarantee it required against any injury arising out of a liability whose origin had not been revealed or a tax liability which was identified but uncertain. The independent auditor had evaluated the guarantee for the tax risk at FRF 123 million, and this figure was shown to those who inspected the documentation.

Banque Chaix, the only prospective buyer to make a firm offer, asked for a guarantee against unrevealed liabilities and inaccurate statements amounting to FRF 300 million. On 12 June 1998 Banque Chaix signed the contract to take over SMC, subject to the condition that the Commission approve the aid given to SMC by the State.

The Commission has examined the letters that the Treasury's consultant bank sent to the banks contacted with a view to the privatisation of SMC; the replies from those banks; the valuation report on SMC drawn up by the consultant bank, which was available to those allowed to inspect the documentation; the draft contract of sale given to those prospective buyers; and the contract for the transfer of the shares in SMC signed by the buyer. On the basis of the information in its possession the Commission is satisfied that the procedure followed ensured the necessary impartiality and transparency for the sale.

In addition, the State has imposed no obligations on the buyer which might entail additional costs justifying a reduction in the price of privatisation, other than those linked to the implementation of the recovery plan.

The Commission is accordingly satisfied that there is no element of aid either to SMC or to the buyer in the privatisation procedure followed.

5.2.2. The capital injections and the guarantee

In its decisions to initiate these proceedings and then to extend them the Commission indicated that the capital injections might include a State aid component caught by Article 92(1) of the Treaty. SMC is a publicly-owned bank set up by the State and controlled by the authorities, so that any injection of funds into it by the authorities constitutes State aid if in ordinary market conditions a private investor would not have done the same(11). If there is aid the Commission has to determine whether it is compatible with the Treaty.

(11) In order to determine whether injections of public money into an enterprise constitute State aid, the Commission applies the principle of the private investor in a market economy: see the Commission communication to the Member States (OJ C 307, 13.11.1993, p. 3).
The recapitalisation measures which may contain elements of State aid are: the capital increases in 1993, totalling FRF 860 million; the capital injections in 1994 and 1995, amounting to a total FRF 1 241 million, entered in the accounts for 1994; the capital injections in 1996, amounting to FRF 858 million, entered in the accounts for 1995; and the capital injection announced in 1998, to be entered in the accounts for 1997, amounting to FRF 2 909 million; this gives an unadjusted total of FRF 5 868 million. The State guarantee of FRF 423 million may likewise include a State aid component.

Table 2
Injections of capital by the State into SMC considered in these proceedings

<table>
<thead>
<tr>
<th>Date</th>
<th>Funds provided (million FRF)</th>
<th>Observations</th>
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<tbody>
<tr>
<td>1993</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First instalment</td>
<td>460</td>
<td>On 13 October 1993, the Commission concluded that the contributions of funds planned for 1993 to 1994, totalling FRF 860 million, were outside the scope of Article 92.</td>
</tr>
<tr>
<td>Second instalment</td>
<td>160</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First instalment</td>
<td>95</td>
<td>The first instalment, FRF 95 million, and FRF 145 million of the second instalment, giving a total amount of FRF 240 million, are to be regarded as included in the contributions proposed in 1993 which were approved by the Commission on 13 October 1993. The amount on which the Commission did not take a decision is FRF 181 million.</td>
</tr>
<tr>
<td>Second instalment</td>
<td>326</td>
<td></td>
</tr>
<tr>
<td>1995 (1)</td>
<td>1 060</td>
<td>Information supplied at the end of April 1995</td>
</tr>
<tr>
<td>1996 (1)</td>
<td>858</td>
<td>Information supplied at the beginning of June 1996</td>
</tr>
<tr>
<td>1998 (1)</td>
<td>2 909</td>
<td>Information supplied in June 1998</td>
</tr>
<tr>
<td>Total at current prices</td>
<td>5 868</td>
<td></td>
</tr>
</tbody>
</table>

(1) In respect of the previous financial year.

On 13 October 1993, the Commission concluded on the basis of the information available that the capital injection proposed in 1993 for the period 1993 to 1994, totalling FRF 860 million, was outside the scope of Article 92 of the Treaty.

In the course of the proceedings, the Commission has been shown observations made by the Commission Bancaire in a letter of 27 December 1994 to the chairman of SMC’s board of directors: the Commission gathers from these observations that the 1993 recovery plan did not follow the recommendations of the Commission Bancaire, which had drawn attention to weaknesses in the bank’s system of risk assessment. The Commission Bancaire emphasises that the development of new activities such as market operations and property financing and of specialised subsidiaries has not always been accompanied by the introduction of measurement and monitoring machinery, with the result that management and directors have sometimes not been aware or have had only an incomplete picture of the risks being taken. The Commission Bancaire indicates that some of these weaknesses had already been pointed out in an earlier report in 1992, and nevertheless still existed in 1994. The Commission Bancaire takes the view that in 1993 and 1994 no progress was made with supervision of assistance to property developers or of market operations, or with headquarters control over the network of branches and subsidiaries.

Thus, SMC’s negative results derive in part from factors internal to the bank which were foreseeable but which apparently were not taken into account when the 1993 restructuring plan was drawn up. These factors were not brought to the Commission’s attention when it assessed the first capital injection, for 1993, which amounted to FRF 860 million.

The Commission now takes the view, therefore, that the injection of capital by the State in respect of the year 1993 does constitute aid caught by Article 92: the State, as the shareholder, ought to have been aware that the capital injection would not produce a normal return; and indeed rather than being able to anticipate an appropriate return on its investment, without having to provide further financing, the State actually had to inject additional capital which amounted to even more than what had been decided in 1993.

The successive capital injections in 1994, 1995 and 1997 became necessary for SMC’s survival because the comprehensive restructuring measures applied since 1993
failed to achieve some of their objectives and were not sufficient to restore the bank to viability. Under the plan, the bank ought to have made a loss of about FRF 190 million in 1993 and become profitable from 1994 onward. In fact the loss in 1993 turned out worse than forecast, at about FRF 317 million, and 1994 ended in a loss of FRF 1 257 million. SMC had to turn to its shareholder in order to comply with the minimum solvency ratio of 8%. The same thing happened in 1995. Given the worsening in the bank's financial situation in 1997, the State decided to launch the procedure for the sale of SMC, because it had concluded that the only possible way to ensure that the bank had any future was to associate it with a solid partner with the know-how needed to complete its restructuring. At the same time the State would recapitalise the company for the last time in order to cover losses made and risks incurred by the bank in the past.

Without the injection of State capital the bank would have been obliged to seek bankruptcy proceedings. SMC is being sold to a private buyer, who undertakes to restructure it; the price to be paid is FRF 10 million, so that the State has not recovered its investment nor obtained a return in proportion to the risk of the operation. The State has not acted as a private investor in a market economy would have done, and the measures it has taken to assist SMC must be considered State aid.

Turning now to the scale of the aid, it must be borne in mind that all the increases in capital were intended to cover losses. The State financing was therefore almost entirely non-refundable. It must be concluded that the State aid component in the capital injections is equal to the whole sum of FRF 3 868 million.

The Commission has also to evaluate the aid component in the guarantee of FRF 423 million given by the State. The State here undertakes to indemnify the buyer for any injury caused by a liability whose origin was not revealed to it, or by a tax liability which is precisely identified but uncertain. Whether or not this guarantee will be invoked is not clear, because of FRF 5 868 million.

The independent auditor evaluated the guarantee against tax risks at FRF 123 million, and this figure was given to those allowed to inspect the documentation. The draft contract given to those prospective buyers asked each of them to indicate the amount of the guarantee it required against unrevealed liabilities and inaccurate statements. The buyer who made a firm offer evaluated the guarantee for unrevealed liabilities and inaccurate statements at FRF 300 million.

In view of SMC's financial position, and the fact that its real provisioning requirements have been underestimated in the past, it is reasonable for a buyer seeking to determine the amount that should be covered by a guarantee of this kind to be particularly prudent. The Commission considers, therefore, that this valuation of the guarantee is justified, and that the aid component is equal to the amount guaranteed. The tax risk was evaluated by the independent consultant at FRF 123 million; in view of the uncertainty of the precise determination of the risk, there should be a margin of variation of 10% up or down in the value of the guarantee covering it. The Commission should accordingly set the maximum State aid authorised by way of guarantee at FRF 435.3 million.

In their letter of 21 April 1997, the French authorities observed that these capital injections were the solution least costly to the State as shareholder.

The Commission accepts, indeed it is convinced, that the confidence of depositors and markets in the sound operation and stability of credit institutions must be maintained. Respect for market discipline, with the possibility that structurally unprofitable credit institutions may be penalised and in some cases pushed out of the market, is one of the foundations of that confidence. To keep alive institutions which have no prospect of recovery provokes serious distortion of competition, raises a problem of moral hazard, and ultimately renders the rest of the banking system more fragile. It also seriously distorts the allocation of funds, and thus leads to lopsided development in the economy as a whole.

In a market economy, shareholders will as a rule support an economic activity if it has sufficient prospect of profitability in the long term. Conduct of that kind will usually be compatible with the private investor principle.

In exceptional cases a shareholder may judge it advisable to provide support even though there is no sufficient prospect of the business becoming profitable, in order to safeguard his own reputation. In order to establish that the conduct of the State in its capacity as shareholder does not constitute State aid, therefore, it must first be shown that its reputation is at stake in the particular case in the same way as the reputation of a private shareholder might be. But even if that test is satisfied, the State still cannot escape the application of Article 92 of the Treaty without contravening Article 222. If that were possible, public enterprises, whose shareholders have unlimited powers of intervention, would all be outside the scope of Article 92. Where the shareholder is the State, therefore, any contribution on its part that goes beyond what a private shareholder would normally provide in similar circumstances can be considered State aid liable to cause distortion of competition.

The Commission takes the view that, in the event of a liquidation, it is only exceptionally that a shareholder will be liable beyond the amount of his shareholding. He may have a
specific liability in cases of fraud, or in the case of
mismanagement or wrongful conduct of the kind cited by the
French authorities here, if he can be shown to have committed
the offence, and then only to the extent of the financial
consequences of his actions. But even if it were to be
shown that the State as shareholder could be deemed to be a
director or manager of the business, in law or in fact, or that it
had committed acts of mismanagement or other wrongful acts
causing injury to others, and that the financial injury for which
it was liable was equal to the amount of the aid, such rules
could not allow the State to escape the application of
Article 92 without breaching the principle of law according to
which one is not entitled to base a claim on one's own
wrongdoing (nemo auditur propriam turpitudinem allegans). The
Commission takes the view, therefore, that the general
principle of the limited liability of a shareholder in a limited
company applies here as elsewhere.

The French authorities have cited the first paragraph of
Article 52 of the French Banking Law; the Commission does
not contest the validity of this provision in the light of the
European Banking Directives. But it would point out that
under this rule shareholders are to be asked to support a credit
institution that finds itself in difficulty, but they are not
required to do so. Neither the French authorities nor the other
interested parties have referred to any obligation on the part of
shareholders to provide support. In some French bank failures
the shareholders have been asked to support the bank by the
Governor of the Banque de France, and have refused; and in
the recent Compagnie du BTP case the Paris Court of Appeal
confirmed that Article 52 of the Banking Law was not to be
interpreted as binding on the shareholders. Where the
main shareholders in banks have indeed provided support,
they have done so either to safeguard their interests as owners
of other businesses or to avoid graver legal consequences. This
cannot be taken to mean that a shareholder in a bank is
always and everywhere under a general obligation to meet the
bank's liabilities. Such an obligation would de facto run counter
to the principle that the liability of the shareholders is to be
borne by them in proportion to the capital they have
contributed to the company. And if such an obligation existed
it would constitute discrimination between privately-
and publicly-owned banks, because a private investor does not
have access to the same unlimited resources as the State. In
practice, it would make it impossible for a private shareholder
to have majority control of a privately-owned bank of any
size, because of the colossal sums it might be called on to find,
and would thus further discriminate between privately-
and publicly-owned banks.

The French authorities argue that in its capacity as shareholder
the State ought to bear the company's liabilities by reason of a
responsibility for a lack of supervision or for negligence on its
own part in the exercise of the authority it has over
institutions of this kind; the Commission would point out that
when seeking to determine whether or not State action

constitutes State aid, a distinction has to be drawn between
costs that the State may have to bear in its capacity as
shareholder and costs that it may have to bear for other
reasons, in particular in its capacity as the authority
responsible for monetary and financial stability. The argument
that the State as shareholder is liable for outstanding liabilities
on liquidation, over and above its contribution to the capital,
had already been rejected by the Commission and by the Court
of Justice of the European Communities, on the grounds that
to extend its liability in this way would blur the distinction
between the roles of the State as shareholder and the State as
guardian of public welfare. When the costs of the course
chosen are to be compared to the costs of alternatives, then,
the only costs that are relevant are those borne by the State in
its capacity as shareholder, because the answer to the question
whether there is State aid depends on how the State behaves
as compared with how a private investor would behave. It will
be obvious that other irrelevant costs, such as social costs or
taxes, may not be included in the comparison either, because
in ordinary circumstances the company or the shareholders
would have to bear these costs out of their own resources, and
in the event of liquidation the shareholders would not be liable
for them beyond the value of the capital or guarantees they
have subscribed.

In SMC's case, the Commission would point out first of all that
the cost of the reorganisation to the State would have been
lower if an in-depth analysis had been carried out and drastic
restructuring measures taken earlier — certainly no later than
the first report by the Commission Bancaire in 1992. A private
investor might have been expected to intervene following the
poor results at the beginning of the 1990s, rather than waiting
until the company had made losses for seven consecutive years
before taking the necessary restructuring measures. In taking
this passive stance, the State was not acting as a prudent
shareholder would. Thus, the French authorities' argument that
the cost of winding up would have been heavier than the cost
of recapitalisation cannot be accepted.

Secondly, the Commission rejects the argument seeking to
extend the liability of the State as shareholder to include any
outstanding liabilities on liquidation beyond its contributions
to the capital of the company for the following reasons:

— the argument for extending liability has not made any
distinction between the State's obligations as shareholder
and the obligations it considers itself bound by in other
capacities, as guardian of the public welfare with a duty to
preserve social stability, for example, or as the monetary
authority,

(2) See Articles 179 and 180 of the French Law of 25 January 1985
on company recovery and compulsory winding up, Journal officiel
(3) Judgment delivered on 13 January 1998.

(14) See in particular the Commission Decisions in Bull (OJ L 386,
and Elfin (OJ C 349, 29.12.1993, p. 2), and the judgment of the
Court of Justice in Hytasa (Joined Cases C-278/92, C-279/92 and
(15) Always provided these are guarantees subscribed on commercial
terms and do not constitute State aid measures.
— the extension of liability has been presented as unconditional and unlimited, rather than in the restrictive framework of the 1985 Act. In particular, the French authorities have not shown that the State as shareholder was in law or in fact responsible for the management of SMC, and that by virtue of that position it was under an obligation to grant the aid at issue, by reason of a responsibility for fraud, or mismanagement, or wrongful acts causing injury to others. Nor have they shown that the financial consequences of any such responsibility were equal to the amount of the aid,

— even if all these factors had been proven, which they have not, they could not permit the State to escape the application of Article 92 without contradicting the principle of law, already mentioned, that one may not base a claim on one's own wrongdoing,

— the authorities have not argued that the reputation of the State is at stake here in the way that a private shareholder's reputation might be. But even if this argument had been invoked, it could not permit the State to escape the application of Article 92 without infringing Article 222.

Accordingly, a private investor would not have carried out such recapitalisation or given such a guarantee; and as the measures are liable to affect trade between Member States, they do contain elements of State aid within the meaning of Article 92(1). As the Commission made clear at the outset of the proceedings, the measures may be held to be compatible with the common market only under Article 92(3)(c), on the basis of the new restructuring plan put forward by the buyer, which must in particular show that the company can become viable.

5.2.3. The possibility that the selling price might involve aid to the buyer

When it extended the proceedings on 14 July 1998, the Commission said it would have to check whether, in the light of the privatisation procedure pursued, the selling price might involve aid to the buyer.

At recital 5.2.1, the Commission concluded that the privatisation procedure ensured that SMC's shares were transferred with the necessary impartiality and transparency.

The bank acting as consultant to the Treasury has estimated the value of the company; if the buyer, Banque Chaix, bought the shares at a price below their value, there would be a presumption that it had received State aid.

The value of SMC as estimated by the Treasury's consultant bank, after recapitalisation by the State and before deduction of the costs of any redundancy programme, varies between FRF 50 million and FRF 250 million. The consultant bank used several methods ordinarily applied in the valuation of businesses, based on revalued net assets, current stock exchange value, and current transaction value of the own funds. The consultant bank's valuation clearly specifies that it takes no account of restructuring costs deriving from a reduction in staff; it has been estimated that a restructuring plan costing between FRF [...] (*) million and FRF [...] (*) million is needed, which would have to be paid for by the buyer.

On the basis of this valuation, and once the restructuring costs deriving from a reduction in staff are taken into account, the value of the bank is negative.

Under the privatisation procedure followed, which is considered to be impartial and transparent, the only firm offer for the acquisition of SMC was that made by Banque Chaix, which offered FRF 10 million. The recovery plan, to be paid for by the buyer, will cost Banque Chaix a total of some FRF 950 million, equal to the accumulated losses forecast for the three years 1998, 1999 and 2000: in order to comply with the regulatory solvency ratios it will have to offset these losses by recapitalising the company.

The total cost to be borne by the buyer includes the cost of implementing the redundancy programme, which has been estimated at around FRF [...] (*) million. Even allowing for the possibility that the buyer might invoke the State guarantee of FRF 423 million for any unidentified risks, the price paid is a positive price, and exceeds the value estimated by the consultant.

The Commission concludes that the selling price agreed by the parties is a market price and does not involve aid to the buyer.

5.3. The compatibility of the aid granted

In considering the compatibility of the aid the Commission will be following the general principles set out in the

(*) Some parts of this text have been edited so as not to disclose confidential information; those parts are contained in square brackets and asterisked.
Community Guidelines on State aid for rescuing and restructuring firms in difficulty\(^{(16)}\), which clarify the tests which must be satisfied if aid of this kind is to be considered compatible with the Treaty. The measures at issue here are not ‘rescue’ measures within the meaning of the Guidelines, because they are not temporary measures taken pending a restructuring operation, so that it remains to be considered whether they constitute restructuring aid, and if so whether they satisfy the tests for the compatibility of restructuring aid.

The Commission believes that restructuring aid can ‘facilitate the development of certain economic activities’ and ‘does not adversely affect trading conditions to an extent contrary to the common interest’ where the following conditions are met.

1. There must be full implementation of a restructuring plan which within a reasonable time restores the requisite minimum return on capital invested, and thus ensures the long-term viability of the business.

2. There must be a *quid pro quo* sufficient to offset the distortive effect of the aid on competition, so that it can be concluded that the aid is not contrary to the common interest.

3. The aid must be in proportion to the objectives pursued, and limited to the strict minimum necessary to enable restructuring to be undertaken, so that the effort of recovery is as far as possible borne by the firm itself.

4. The restructuring plan must be implemented in full, and any other obligations laid down by the Commission decision must be discharged.

5. Arrangements must be made for monitoring compliance with the preceding condition.

The information supplied by the French authorities at the time of the injections of capital into SMC in respect of 1993, 1994 and 1995 did not enable the Commission to make a proper assessment of the viability of the bank.

The new State measures to be taken in respect of 1997 are thus partly the result of the fact that the attempts at comprehensive restructuring undertaken since 1993 have failed.

The Commission accordingly takes the view that in these proceedings all the measures in support of SMC that constitute State aid should be considered for their compatibility with the Treaty together, in the light of the most recent restructuring plan, which was drawn up by the buyer.

5.3.1. The restructuring and viability measures

The restructuring plan submitted is based primarily on a continuation of the rationalisation already undertaken in the last few years. In the period 1994 to 1996 non-strategic holdings were sold off for FRF 221 million. Steps were also taken to reduce operating costs; these included staff reductions of about 1,000 (772 between 1990 and 1994, and 210 between 1994 and 1997), and out-sourcing of financial and administrative skills within the retail banking business. SMC’s commercial position declined by 20% between 1995 and 1997. In the area it covers, its share of total funds employed fell by 20%, from 2.55% in December 1995 to 2.02% in the second half of 1997.

Banque Chaix proposes to make SMC into a profitable regional bank able to finance its own development; this will require further efforts in a number of areas:

— the remaining non-core businesses will have to be abandoned, and wound up or sold off,

— there will have to be a significant and lasting reduction in operating costs,

— organisation and working methods will have to be modernised and simplified.

The plan put forward by Banque Chaix covers the period 1997 to 2002; the main points are as follows.

(a) SMC is to concentrate entirely on its core business as a local bank. Its balance sheet will contract by FRF 2,910 million, equal to 12.6% of its 1997 figure, as a result of the closure of its banking subsidiary Soficim (5% of the 1997 balance sheet), the abandonment of assistance to property developers (2% of the 1997 balance sheet), the ending of other property business (3% of the 1997
balance sheet), the ending of venture capital business (0.7% of the 1997 balance sheet), the sale of GP Banque, and the abandonment of lending to local authorities.

(b) A redundancy programme is to be implemented, paid for by Banque Chaix, costing some FRF [...] (*) million, and saving 28% of staff expenditure in 2002 by comparison with 1997. It is planned that in 2002 the staff will number [...] (*) as compared with [...] (*) in 1997. This redundancy programme comes on top of the two earlier redundancy programmes, which cost a total of FRF 256 million and achieved a saving of about 10% in staff costs.

(c) Overheads other than staff costs are to be reduced by 26% in 2002 as compared with 1997, as a result of administrative rationalisation and simpler and slimmer structures.

Table 3

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<td>948</td>
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<td><a href="*">...</a></td>
<td><a href="*">...</a></td>
<td><a href="*">...</a></td>
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</tbody>
</table>

Table 3

Business plan for SMC submitted by the buyer

Net receipts from banking 1 211 947 907 948 1 004 1 083
Staff costs -691 -676 -684 -595 -510 -520
Severance payments -30 -30 0 0 0 0
Other overheads and depreciation -437 -390 -347 -342 -338 -325
Total charges -1 158 -1 096 -1 031 -937 -848 -845
Gross operating profit or loss 53 -149 -124 11 156 238
Operating ratio 95.6% 115.7% 113.7% 98.8% 84.5% 78.0%
Provisions -3 153 [...](*) [...](*) [...](*) [...](*) [...](*)
Profit or loss after provisioning -3 100 [...](*) [...](*) [...](*) [...](*) [...](*)
Cost of restructuring plan (1) 0 [...](*) 0 0 0 0
Profit or loss -3 100 [...](*) [...](*) [...](*) [...](*) [...](*)
Accumulated profit or loss 1998, 1999, 2000 -950
Own funds after recapitalisation 487 [...](*) [...](*) [...](*) [...](*) [...](*)

(1) Cost of social restructuring, including all spending linked directly or indirectly to the redundancy programme.

As a result of these measures the decline in the company's business should stop in 2000. In the first phase of the restructuring plan (1998 to 2000), it is expected that operating results will worsen significantly once again: the correction of assets and the reduction of exposures will lead to a big drop in net receipts from banking; at the same time reorganisation and the slimming down of the bank will bring major extra costs. The total amount of losses over the period 1998 to 2000 will be about FRF 950 million.

These new operating losses will necessitate one or more injections of capital by the buyer, totalling FRF 950 million. This recapitalisation will cover only the fresh operating losses recorded between 1998 and 2000, and will not increase the amount of SMCs own funds after profit or loss, or its overall financial capacity. Banque Chaix's intention is to hold SMC's own funds to the regulatory minimum of 4%. Given the changes in weighted exposures associated with the concentration on core business and the reduction in capacity, the level of SMCs 'hard' own funds will remain below FRF 500 million throughout the period 1998 to 2001.

The bank is expected to be profitable once again in 2002, with a return on own funds of about 20% and a return on the buyer's investment (ROI) of about 11%. This would be the result of an appreciable recovery in the operating ratio, brought about by the redundancy programme and the synergies achieved in cooperation with the buyer's own group, and a return to a normal pattern with regard to the cost of risk.

The Commission concludes that the first test laid down in the Guidelines, namely that the firm must be restored to viability within a reasonable time, is satisfied.

5.3.2 The quid pro quo

In order to ensure that the aid does not have the effect of restoring to the market a firm which is excessively strong and
in a position revert to an unreasonably aggressive policy, the
firm receiving the aid must finance a significant part of the
costs of restructuring out of its own resources. Under the
principle laid down in the Guidelines, the recipient firm must
not merely sell off subsidiaries and lines of business which are
a burden on its accounts, but must also dispose of quality
assets and subsidiaries, thus securing the resources necessary to
finance restructuring, minimising the demands made on the
public purse, keeping the amount of new aid to a minimum,
and forcing the firm to make a significant contribution to its
own restructuring.

Since 1992, SMC's balance-sheet total has been falling
continuously, from FRF 24,597 million in 1992 to FRF
23,149 million in 1997, a drop of 16%. This decline is the
result primarily of a reduction in loans and advances to
customers, reflecting the fall in funds employed (a drop of
18.9% between 1994 and 1997), and of a 40% reduction in
leasing business as a result of the gradual decline in the
volume of business of SMC's subsidiary PBS.

But these reductions are in part due simply to poor
management.

The further action taken by SMC, and the business plan
proposed by the private buyer, make provision for additional
offsetting measures of three kinds.

(i) The immediate and definitive abandonment of five lines of
business

— the closure of Soficim, one of the last French
institutions specialised in real-estate loans direct to its
own clientele (which is separate from the clientele of
the network),

— the sale of GP Banque, which was to have been the
vehicle of SMC's development in the international
sphere,

— an end to the property-leasing business centred on the
subsidiary PBS, which is to be sold,

— the abandonment of lending to local authorities, and
sale of the portfolio,

— an end to the venture capital business, which had been
built up via several specialised subsidiaries.

This will involve a further reduction of FRF 2,910 million
in SMC's balance sheet, equal to 12.6% of the 1997
balance sheet and 10% of net receipts from banking in
1997.

(ii) Reduction of retail banking business

Over the two years 1998 and 1999 SMC's net receipts
from banking are to fall by 25% by comparison with
1997, which was itself 15% down on 1996. Over the
same period exposures on customer business and on
securities portfolios will fall by the same proportion. This
reduction in the retail banking business will result from
deliberate action undertaken to regain control of credit
policy and from the options for the targeting of customers
set out in the buyer's plan.

(iii) Out-sourcing of specialised financial and administrative
skills

Within the retail banking business SMC intends to hive off
specialised activities, especially:

— safekeeping of securities,

— management on behalf of third parties: SMC will no
longer itself produce the financial products it sells to
customers, where there was FRF 5.5 billion
outstanding on 31 December 1997,

— cash and market activities,

— handling of cheques.

In view of the considerations regarding the viability of
SMC and the quid pro quo required which are set out
above, in particular at point 5.3.2(i), the Commission
takes the view that the condition laid down in the
Guidelines that there be no undue distortion of
competition is met.

5.3.3. Other conditions

There are other conditions that must be met under the
Guidelines.

The principle that aid must be limited to the strict minimum
means that SMC's own funds must be sufficient to meet its
regulatory obligations but must not be increased beyond what
is strictly necessary. The Commission observes that the scale of
the recapitalisation being carried out by the State is dictated by
its obligation as the shareholder to comply with the rules on minimum own funds, unless it decides instead to wind up the bank. The buyer is left free to inject what further capital it considers appropriate in view of the SMC's activities and portfolio; so that it can be concluded that after State aid has been granted SMC's level of capitalisation will not be such as to strengthen it beyond what is strictly necessary for its restructuring.

In accordance with the Guidelines, the losses offset by the capital increases must not be carried over for tax purposes.

Lastly, it must be established that the restructuring plan has been properly implemented. The French authorities should submit six-monthly reports to the Commission from the date of the Commission decision and until the date of performance of the commitments in the restructuring plan.

6. CONCLUSIONS

The Commission concludes that the capital increases in 1993, 1994, 1995 and 1997, which totalled FRF 5,868 million, and the guarantee of FRF 423 million contain elements of State aid within the meaning of Article 92(1) of the Treaty. Given the uncertainty of the precise value of the tax risk, the guarantee covering that risk can be considered subject to a margin of variation of 10% on either side. The total estimate of the aid authorised is accordingly FRF 6,303 billion.

Consideration has been given to the measures in the light of Article 92(3)(c) of the Treaty to establish whether they can be considered compatible with the common market. The Commission is satisfied that the aid given to SMC meets the conditions laid down in the Community Guidelines on State aid for rescuing and restructuring firms in difficulty. The aid accordingly qualifies for exemption from the prohibition in Article 92(1) of the Treaty and Article 61(1) of the EEA Agreement, because it may be considered compatible with the common market under Article 92(3)(c) of the Treaty and Article 61(3)(c) of the EEA Agreement.

HAS ADOPTED THIS DECISION:

Article 1

The measures taken by France to support SMC, taking the form of capital increases of FRF 5,868 million and a State guarantee of FRF 423 million, constitute State aid within the meaning of Article 92(1) of the Treaty. They are hereby declared compatible with the common market and with the EEA Agreement in accordance with Article 92(3)(c) of the Treaty and Article 61(3)(c) of the Agreement, subject to the conditions in Article 2. The aid hereby authorised is limited to FRF 6,303 billion.

Article 2

1. France shall confirm that the company will fully implement the restructuring plan submitted to the Commission, including the reductions in activity proposed therein.

France shall submit to the Commission detailed six-monthly reports containing all the information the Commission needs to be able to verify that the restructuring plan is proceeding properly.

2. France shall ensure that SMC cannot carry forward for tax purposes the losses offset by the capital increases.

Article 3

Within two months of notification of this Decision France shall inform the Commission of the measures taken to comply with it.

Article 4

This Decision is addressed to the French Republic.

Done at Brussels, 14 October 1998.

For the Commission
Karel VAN MIERT
Member of the Commission