

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 27 July 1994

concerning the subscription by CDC Participations to bonds issued by Air France (93/C 334/04)

(Only the French text is authentic)

(Text with EEA relevance)

(94/662/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

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

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

Having, in accordance with the abovementioned Article of the Treaty, given notice to the parties concerned to submit their comments and having regard to those comments,

Whereas :

I

By letter of 22 April 1993, registered with the Commission on 27 April 1993, the French Government, upon a request from the Commission of 1 March 1993, belatedly notified the Commission of two issues of bonds by the State-owned company, Compagnie Nationale Air France, (hereinafter referred to as 'Air France') taken up by State-owned company, CDC Participations, (hereinafter referred to as 'CDC-P'), which is a subsidiary of the Caisse des Dépôts et de Consignations (hereinafter referred to as 'the Caisse').

On 28 May 1993 representatives of Air France and the French Government held a meeting in Brussels with the

responsible officials of the Directorate-General for Transport. The French authorities provided a number of documents which were registered with the Commission on 1 June 1993.

The aid was registered as non-notified aid on 19 July 1993 with the Commission Secretariat-General.

On 10 November 1993 the Commission decided to open the Article 93 (2) procedure with regard to the abovementioned transaction between Air France and CDC-P. The French authorities were informed of this decision by letter of 7 December 1993. This letter was published in the Official Journal⁽¹⁾ and the interested third parties were invited to comment on the case.

The decision to open the Article 93 (2) procedure was taken because the Commission had concerns on the nature of the aid and its adverse effects on trade within the common market. In particular the Commission needed to clarify whether the granting of the aid was actually linked to a restructuring plan. Had this been the case, the Commission needed assurances that Air France was using and would use the money received solely for the purposes of its internal restructuring. Moreover, the Commission needed further assurances that the aid to Air France would not affect trading conditions to an extent contrary to the common interest. In order to verify that the aid would not be used by Air France to transfer its difficulties to its competitors, the Commission needed to be assured that the aid to Air France would not have

⁽¹⁾ OJ No 334, 9. 12. 1993, p. 7.

unacceptable anti-competitive effects on Community and, in particular, on domestic routes. To this end the Commission requested the French Government to provide the necessary information to carry out this assessment.

II

The French authorities replied to the Commission by letters of 7 January and 17 May 1994.

The main arguments of the French authorities may be summarized as follows :

- (a) the French authorities did not notify the operation to the Commission prior to its taking place as they do not consider such financial intervention to be State aid ;
- (b) the Caisse, and in consequence CDC-P, are entities autonomous from the French Government. CDC's autonomy is guaranteed by the fact that it is subject to the surveillance of the Parliament (and not of the Government). This independence is further confirmed by the status of CDC's Director-General, who is appointed by the President of the French Republic and enjoys particular autonomy. The Director-General can only be dismissed following an exceptional procedure (President of the French Republic's decree following a reasoned request from the 'Commission de surveillance', which is a body composed of Members of Parliament, judges, and a representative of the 'Ministre de l'Économie et des Finances'). Moreover, when he is appointed, the Director-General, who is the official in charge of managing the Caisse, takes an oath to guarantee the independence of the Caisse ;
- (c) on 17 February 1993 CDC-P decided to invest in Air France, on the basis of a strategic analysis finalized at the end of 1992. By the end of 1992 the situation of Air France was comparable to that of its competitors as 1992 had been a difficult year for the world's civil aviation industry as a whole. Air France's debt ratios were, for the most part, similar to those of its competitors. Moreover, at the end of 1992, prospects for 1993 were generally optimistic, although subsequent events were to undermine this assumption. In particular, the plan, drawn up in October 1992, forecast recovery in the short term, assuming for 1993 an increase in passenger traffic of 6,1 %, stabilization of unit revenues, and a deficit of FF 1,6 billion CDC-P decided to invest in Air France taking into account these good prospects and the interest rates of the two bonds, which were in line with market rates. The projections were, however, not confirmed by events because the economic crisis in the civil aviation industry deteriorated in the first half of 1993 and the French domestic market was affected by a specific recession (in the first half of 1993 the amount of sales of air transport services in the French domestic market decreased by 7,7 % over the corresponding period in 1992 whilst
- (d) the above analysis was confirmed by the participation in the operation of foreign private investors who wished to subscribe to FF 26 million of bonds redeemable in shares, i.e. 'obligations remboursables en actions' (hereinafter referred to as 'ORA'). Their request could not be fully met (the private investors were allowed to subscribe FF 1,7 million ORA) as this would have implied a partial privatization of Air France, which would have required a special procedure⁽¹⁾. The private investors' presence is evidence that the subscription conditions were attractive and conformed to those of the market ;
- (e) the investment was linked to the restructuring plan drawn up in October 1992 (the 'Plan de retour à l'équilibre', hereinafter referred to as 'the PRE1'). The Commission could not have concluded, in the light of the subsequent deterioration in Air France's results in 1993, that the plan was inadequate to overcome the crisis facing the airline. Furthermore, the investment could not be linked to another plan (known as 'PRE2'), which was to be proposed by Air France in May/June 1993 (i.e. after the subscription to the bond issues) to strengthen the PRE1 ;
- (f) the sole objective of the investment was to contribute to the restructuring of Air France. The financial injection could not have affected competition on intra-Community routes as Air France in 1993 lost market shares on the international intra-Community routes (Air France's air traffic between the airports of Paris and other Member States decreased by 1,1 points during the first 10 months of 1993 compared with the same period in 1992, from 36,7 % to 35,6 %). As regards French domestic routes, the position of Air France is not particularly sizeable. Air France operates the routes between Paris/Charles de Gaulle-Nice and Paris-Overseas Departments. Air Inter, which is the French carrier that operates the main French domestic routes, did not receive any financial contribution from Air France and should be considered as a company independent from Air France ;

the British and German domestic markets grew by more than 6,3 and 5,3 points, respectively). This slowing down had a negative effect on Air France's performance.

Besides these short-term considerations, CDC-P decided to invest in Air France because the growth prospects of the air transport sector in the longer term were rather good. CDC-P, taking into consideration the potential of Air France (a modern fleet, qualified personnel, world-wide markets, etc.), behaved as a rational investor. At the time the decision was taken, CDC-P could not have foreseen the down-turn of Air France's activity in 1993 ;

⁽¹⁾ Decree following an opinion from the 'Commission d'évaluation des entreprises publiques'.

(g) the issues relating to access to the French domestic market, which the Commission raised in opening the Article 93 (2) procedure, are not directly related to the present case and should be treated separately.

III

The United Kingdom, Denmark, the Netherlands, and a number of Air France's competitors, among which British Airways, British Midland and TAT, submitted comments on the case, which the Commission duly transmitted to the French authorities.

The third parties agreed in general with the Commission's assessment on the aid nature of the operation and its distortive effects on competition and trade. A number of Air France's competitors stressed that the aid is incompatible with the common market and should not be authorized. They also stated that the negative effects of the aid on competition and trade were bound to be strengthened by a number of measures adopted by the French Government to maintain Air France's dominant position on the French domestic market because the measures would have the effect of limiting the exercise of traffic rights and access to French domestic routes and protecting the national carrier from competition from airlines not belonging to the Air France group.

IV

Upon a proposal from the Board of Directors of 17 February 1993, the extraordinary shareholders meeting of Air France on 24 March 1993 resolved to issue 1 877 526 ORA, and 483 456 progressive interest subordinated notes with warrants ('titres subordonnés à intérêt progressif assortis de bons de souscription d'actions', hereinafter referred to as 'TSIP-BSA'). The total value involved was approximately FF 1,5 billion, being FF 749 996 535 for the ORA and FF 749 356 800 for the TSIP-BSA, respectively. The subscription period ran from 2 to 28 April 1993.

CDC-P has guaranteed the subscription of all the bonds issued.

Air France's share capital is owned by the State (99,329 %), CDC-P (0,538 %), and some minor private shareholders (0,132 %).

The French Government, as the major shareholder of Air France, decided not to subscribe to any of the two issues. The ORA were subscribed to by some private shareholders in proportion to their share in Air France's capital and by CDC-P for the remaining part (FF 748 080 190).

Nearly all the TSIP-BSA have been subscribed to by CDC-P for an amount of FF 749 335 100.

The securities have the following characteristics :

(a) ORA :

- unitary price : FF 399,46,
- duration : six years and eight months,
- the interest consists of a fixed part (4 %), which is due on 1 May each year and for the first time on 1 May 1994, and a variable part, which is payable for the first time on 1 May 1996. The variable interest depends on the performance of the company, it being calculated on the basis of the ratio between gross operating results ('excédent brut d'exploitation') and turnover (production).

The global expected actuarial interest, assuming a gross profit margin of 15 % over the period 1995/99, is 6,5 %, within fixed limits of 5,5 % and 7,5 % p.a.

The ORA will be obligatorily refunded in shares (one share for one ORA) by 1 January 2000 at the latest. Holders of ORA have the right to demand reimbursement of their bonds in shares at any time before that date.

The internal rate of return of the investment, as calculated by CDC, is 14 %. CDC has taken into account the interest rate of the ORA and the expected increase in value of the bonds after their reimbursement in shares. In mid-January CDC calculated, for its own purposes, the implied value of an Air France ordinary share on 1 January 2000 (i.e. when the ORA will be reimbursed in shares), on the basis of Air France's long-term financial projections.

(b) TSIP-BSA :

- unitary price : FF 1 550,
- duration : indefinite,
- the interest is fixed and increases over the period 1993 to 1999 from 5,5 % to 8,5 % (the average actuarial interest over this period is 7 %); the interest becomes variable as of 1 January 2000. The variable interest will be calculated on the basis of the one-month PIBOR (Paris interbank rate offered) plus a progressive rate. This rate is 1,15 % for the interest payable 1 January 2001 and increases by 0,15 % each year from 2006 onwards up to 2,05 %. The interest is payable for the first time on 1 May 1993.

Each BSA enables the owner of the security to subscribe, until 1 January 2000, to up to three shares of Air France at the price of FF 517 per share.

Air France may reimburse all or part of the TSIP-BSA on 1 January of each year from 1 January 2000. In the case of liquidation or voluntary or forced dissolution of the company the TSIP will be reimbursed after all the secured and unsecured creditors but before the ORA (this is the reason why the securities are called 'titres subordonnés').

The internal rate of return of the investment over the 1993 to 1999 period, as calculated by CDC, is 11,5 %. CDC has taken into account the interest on the TSIP-BSA over this period and the expected increase in value of the bonds (at 1 January 2000), which is calculated on the basis of the expected value of the company at that time.

V

The Commission examined Air France's economic and financial situation in its two decisions of November 1991 on Air France's capital increase and of July 1992 on the ORA and TSDI issues (Case Nos N 653/91 and N 291/91). The total of these financial injections was FF 5,84 billion. In its decisions the Commission recognized that the airline had some financial problems. Air France's capacity for self-financing its investments deteriorated significantly over the period 1988 to 1991. Comparisons with other Community carriers suggested a strong deterioration of Air France's financial structure. The Commission attributed such deterioration to the negative effects for the company of the economic implications of the Gulf crisis, the UTA take-over and the increased financial charges arising from increased expenditure in new investment plans. However the Commission considered that, despite some short-term problems, the long-term prospects and the overall structure of Air France were good. The capital increase and the ORA and TSDI issues were therefore considered as normal financial operations and not as State aid under Article 92 of the Treaty.

The Commission's decisions were also based on the fact that the French authorities had approved, on 1 August 1991, a comprehensive document (the 'Contrat de plan') which set out a restructuring programme (known as CAP '93) and laid down several economic objectives to be attained in the 1991 to 1993 period. Such objectives included, *inter alia*, the following financial commitments:

- the financial restructuring of Air France, whose cash flows should have been sufficient to finance at least 50 % of its investments, thereby reducing the need for further indebtedness,
- the improvement of the company's gross profit margin.

Therefore the Commission concluded in both cases, under the so-called market economy investor principle, that it would not have been unreasonable for a private investor to invest in Air France's capital.

Despite the CAP '93 restructuring programme and the financial injections of almost FF 6 billion in late 1991 and early 1992, Air France's situation continued to deteriorate.

Air France (including UTA) was only able to increase its passenger traffic in 1992 by some 4,2 % (compared to an average of 14 % by AEA airlines). Group revenues decreased by 1,2 % and the group recorded a sharp drop in gross operating results of FF 1,64 billion (1).

The objectives fixed by the CAP '93 programme for the gross operating results of the group could not be achieved; instead of FF 8,1 billion, the results were in 1992, FF 3 billion.

The net operating results which Air France (group) managed to keep positive in the previous year, were significantly in the red in 1992 (minus FF 1,5 billion). The current net results which, according to the plan, should have become positive in 1992, were significantly in deficit (minus FF 3,6 billion). Account has also to be taken of the increasing burden of the financial charges (FF 2,1 billion in 1992) and the negative extraordinary expenses and income (minus FF 699,8 million); the exceptional results had benefited in the two previous years in particular from some real estate sales.

All these factors led Air France in 1992 to the third consecutive negative net result and by far the largest (minus FF 3,2 billion).

Air France's profit indicators reflect the negative results of 1992 which show that Air France was in a worse position than other major European airlines (who were similarly affected by the economic recession).

For Air France, 1993 did not start any better. In the first four months of that year Air France's passenger traffic shrank by 2,7 %, largely on account of weak domestic demand. This is in sharp contrast to AEA results which showed an increase in the first quarter of 9 % for intra-Community traffic.

(1) All the financial figures concerning the Air France group are taken from the Annual Report for 1992. These figures are slightly different from the figures indicated in the decision opening the Article 93 (2) procedure which were provisional figures provided by the French authorities.

Because of the 1992 losses Air France's financial situation seriously deteriorated. By the end of 1992 the group's balance sheet showed a temporary distortion in favour of short-term debts. This situation was corrected through the issue of two long-term bonds in March and June 1993, of a total of FF 3 billion, as well as of the ORA and TSIP-BSA which are now the subject of examination.

More seriously, the financial objectives of the CAP '93 programme could not be achieved. The debt/equity ratios which were to be maintained at the 1990 level (1,2 for the long-term debt) were continually deteriorating. The cash flow situation saw a sharp drop in 1992. The objectives of the CAP '93 plan regarding self-financing capacity (cash flow plus sales of assets) could not be achieved.

The group was far from realizing the objectives set out in the CAP '93 plan to finance 50 % of its investments through cash flow.

Air France's productivity still appeared to be relatively low in the first months of 1993; Air France needed a relatively high number of personnel per aircraft and carried fewer passengers per employee than its major competitors. It is also interesting to note that improvements in productivity measured by available seat kilometres or revenue-passenger kilometres per employee had been lagging behind those achieved by its major competitors.

In conclusion, all these factors indicate that Air France's situation, which was examined by the Commission in its two decisions of November 1991 and July 1992, had continued to deteriorate.

VI

The obvious difficulties Air France encountered in 1992 in pursuing the objectives of its CAP '93 plan, forced the company to review its plan substantially. A new plan (the PRE1) was presented to the Government in the autumn of 1992 and provided for savings or increased revenues amounting to FF 1,37 billion in 1993 and FF 3 billion in 1994 (see below).

VII

Article 92 (1) of the Treaty and Article 61 (1) of the EEA Agreement provide that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States and the Contracting Parties, incompatible with the common market and the Agreement.

In the present case Air France received through CDC-P FF 1,5 billion for the purpose of strengthening its own capital. The French Government, at the time of the issues, waived its right to subscribe in favour of the other shareholders who could subscribe to the whole issues in proportion to their shareholdings in Air France. CDC-P has subscribed for an amount of FF 748 080 190 representing 99,7 % of the ORA (1 873 010 ORA out of 1 877 526), and to 99,9 % of the TSIP-BSA for an amount of 749 335 100 (483 442 TSIP-BSA out of 483 456).

The French Government has indicated that Air France's minor private shareholders asked to subscribe to the issues for an amount higher than that proportional to their existing shareholdings. However, their requests could not be met as it would have been impossible without a specific legislative authorization to proceed to a partial privatization of Air France. This means that it was impossible to allow the private shareholders of Air France to subscribe to the issues for an amount higher than that proportional to their existing holdings.

1. *The Commission has assessed whether the capital injection in Air France was granted by the French State or through State resources.*

In this context, it must be recalled that the Court of Justice has ruled that 'the prohibition contained in Article 92 covers all aid granted by a Member State or through State resources and there is no necessity to draw any distinction according to whether the aid is granted directly by the State or by public or private bodies established or appointed by it to administer the aid' (1). Moreover, in the case of *Van der Kooy*, in deciding whether a preferential tariff charged by a limited company in the Netherlands (*Gasunie*) was the result of action by the Netherlands' State, the Court stated that '... the shares in *Gasunie* are so distributed that the Netherlands State directly or indirectly holds 50 % of the shares and appoints half of the members of the supervisory board — a body whose powers include that of determining the tariffs to be applied...' and concluded that 'considered as a whole, these factors demonstrate that *Gasunie* in no way enjoys full autonomy in the fixing of gas tariffs but acts under the control and on the instructions of the public authorities. It is thus clear that *Gasunie* could not fix the tariff without taking account of the requirements of the public authorities' (2).

(1) Case 290/83, *Commission v. France*, [1985] ECR 439, paragraph 14, p. 449.

(2) Joined Cases 67, 68 and 70/85, *Van der Kooy and Others v. Commission* [1988] ECR 219, paragraphs 36 and 37, p. 272.

The Caisse is a French public entity ('établissement public') which was created by the Law of 18 April 1816 and whose directors and managing personnel are appointed by the French Government upon a proposal from the Minister of Finance. The Caisse owns 100 % of the shares of CDC-P and appoints all the directors of CDC-P, can determine the subsidiary's investment policy through its voting rights, and provide funding for CDC-P financial operations. CDC-P (where, since December 1991, all the shareholdings held by the Caisse are placed), is the instrument to acquire stakes in third companies. Moreover, as pointed out by the French authorities, CDC-P was selected for that purpose because it is a public institution belonging to the State and French privatization laws were not infringed by the capital increase of Air France through CDC-P.

In addition to these legal considerations, the State's control on the investment activity of the Caisse and its subsidiaries has been demonstrated before the Senate (¹).

Although the Commission acknowledges that CDC-P is a limited company under French law whose corporate purpose mainly consists in managing an investment fund, all the conditions are fulfilled to connect the granting of the aid in question with the intentions of the State. The factors indicated above provide considerable evidence that CDC-P is not an autonomous entity from the Caisse, which is subject to the control of the French public authorities. Therefore, the capital injection is an act which is imputable to the French State within the meaning of the Court's case law on Article 92 (1) (²).

2. *The Commission has verified whether the operation is an aid pursuant to Article 92 (1) of the Treaty and Article 61 (1) of the EEA Agreement.*

In order to determine whether State aid is involved the Commission bases its assessment upon the so-called market economy investor principle. According to this principle no State aid is involved where fresh capital is contributed in circumstances that would be acceptable

to a private investor operating under normal market economy conditions (³).

The Treaty and the EEA Agreement establish the principle of neutrality with regard to the system of property ownership existing in the Member States (Article 222 of the Treaty and Article 125 of the EEA Agreement) and the principle of equality between public and private undertakings. As a consequence of these principles, the Commission's action may not prejudice or advantage public entities when they inject capital into undertakings. However, the Commission must investigate financial injections into companies to prevent Member States from infringing the State aid rules of the Treaty. As a general rule the Commission is of the opinion that, in the case of a capital injection out of public funds, no State aid is involved if there are some private minority shareholders who participate in the transaction proportionately to their shareholdings. The private investor's shareholding must, however, have genuine economic significance (⁴). In the present case some private shareholders (some of Air France's employees together with the Bank of New York/London, the Bankers Trust Int., plc and Granite Capital LP subscribed to the ORA and to a minor extent to the TSIP (no bank subscribed to the TSIP)).

However, the private parties' shareholdings in Air France represent only 0,132 % of Air France's capital, and the share of the ORA and TSIP to which they have subscribed is negligible (4 516 ORA out of 1 877 526 and 14 TSIP out of 483 456). Therefore, the private investors' participation in the subscription to the ORA and TSIP-BSA cannot rule out the possibility of the capital injection being a State aid within the meaning of Article 92 of the Treaty and Article 61 of the EEA Agreement. As regards the ORA, the Commission cannot attach decisive significance to the fact that, as alleged by the French authorities, the request from the important private foreign investors was not, for legal reasons, entirely met (the three banks were allowed to subscribe to FF 1,7 million of ORA only, instead of FF 25,9 million as requested: FF 9,9 million of ORA were requested by the Bank of New York/London, FF 7,9 million by the Bankers Trust,

(¹) Information report on the Caisse submitted by Senator Roger Chenaud on behalf of the 'Commission des Finances, du contrôle budgétaire et des comptes économiques de la Nation' to the French Senate. See the Annex to the minutes of the meeting of 9 June 1992, p. 180.

(²) See Case 78/76, *Steinike and Weinlig v. Germany*, [1977] ECR 595, paragraph 21, p. 611, Case 290/83, cited footnote 4, paragraph 12, p. 448, and Cases 67, 68 and 70/85, cited footnote 5, paragraphs 35, 36 and 37, p. 272.

(³) See 'Communication of the Commission to the Member States concerning public authorities holdings in company capital' of 17 September 1984, Bulletin EC No 9-1984 and the Judgment of the Court of Justice in Joined Cases 296 and 318/82, *The Netherlands and Leeuwarder Papierwarenfabriek BV v. Commission* [1985] ECR 809, paragraph 17, p. 823.

(⁴) See Commission communication on the application of Articles 92 and 93 to capital injections out of public funds, in Bulletin EC No 9-1984.

FF 7,9 million by Granite Capital). The number of ORA, to which the three banks sought to subscribe (65 025) represents a small percentage (3,3 %) of the total number of ORA, to which all the investors sought to subscribe (1 942 760). In order to diversify its portfolio an investment bank may decide to make some risky investments. FF 9,9 million and FF 7,9 million do not represent significant outlays relative to the size of a bank's total investment portfolio and thus do not amount to significant risk. The risk of the private investors is, given the small size of their investment in Air France, overall very limited; and, the foreign investors' relatively small investment cannot be considered as conclusive evidence to exclude the possibility of State aid.

The subscription by CDC-P to the ORA may be compared to an equity investment, which is aimed at strengthening the airline's own capital. The ORA are bonds which are compulsorily redeemed in equity and, from a financial perspective, represent a deferred increase in capital. In the case of the ORA the return on investment depends, as has been described above, on the financial performance of the company and on the value of the shares at the time of the conversion. Similar considerations are valid for the TSIP-BSA. The TSIP-BSA are not obligatorily redeemed in shares. However, every TSIP-BSA permits the owner to subscribe until 1 January 2000 for three shares of Air France at a predetermined price of FF 517 per share. The owner may decide not to exercise his subscription right and to continue to receive interest after 1 January 2000 until the company resolves to reimburse the shares. A disadvantage of the TSIP-BSA is that, in the case of dissolution of the company, the owners are reimbursed after all the creditors. This is the reason why such bonds are not very common in the capital markets. The above considerations on the nature of the bonds are confirmed by Air France's prospectus (*Émission de valeurs mobilières composées*, which was published in April 1993 when the bonds were issued) which described the purpose of the two issues as a way of strengthening the company's equity in the long term.

In applying the market economy investor principle the Commission must establish the moment when the aid was granted (i.e. when CDC-P took the final decision to invest in Air France's capital). The time of the decision is important in order to evaluate whether CDC-P, on the basis of objective data, could have reasonably expected an adequate return on the investment. According to the French authorities, CDC-P took its decision to invest in Air France at the end of 1992. CDC-P would have taken that decision in the light of the 'plan de retour à l'équilibre' and at a time when

the sharp drop in traffic of Air France's passenger traffic incurred in 1993 was not expected.

According to the information provided by the French authorities, Air France's board of directors, following negotiations with CDC-P, fixed the detailed rules concerning the bonds and proposed to the shareholders to approve the issue on 17 February 1993. The shareholders' extraordinary meeting then approved the issue of the bonds on 24 March 1993. According to normal business practice CDC-P's investment decision should be considered to have taken place when the bonds were subscribed (i.e. April 1993). The French authorities have not proved that CDC-P were legally obliged to subscribe to the issue before that date. In the absence of a binding legal act, any declaration of CDC-P, before the date of the subscription, should be treated as a mere statement of intention. In any event, even supposing that CDC-P took an irrevocable investment decision before April 1993, the relevant date should, at the earliest, be 17 February 1993 (i.e. the date of the proposal from the board of directors to issue the bonds). Before that date the final details of the issues were not fixed and, thus, CDC-P did not have sufficient information available to take a final decision or to give any kind of commitment.

In the course of the Article 93 (2) procedure the Commission has thoroughly examined the features of the two issues to verify their conformity with market conditions. The returns of the two instruments are strictly dependent on the performance of the company. Before their conversion, the ORA have a significant profit-related element as the interest rate varies according to the cash flow margins recorded by the company (the actuarial interest rates vary from 5,5 % to 7,42 %). Interest (4 %) is paid for the first time on 1 May 1994. After the conversion the ORA become shares and the return depends on the profits only. The TSIP-BSA interest rates are not directly profit-related, but should Air France make a consolidated loss of more than 30 % of the equity in any year then the interest payment in respect of that year could be suspended. Moreover, in the case of liquidation or dissolution, the TSIP-BSA holders have very limited protection because these bonds are repaid after the other creditors. The Commission has stated that State aid is involved 'where the financial position of a company, and particularly the structure and volume of its debts, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested' (1).

(1) Communication to the Member States concerning public authorities' holdings in company capital, in Bulletin EC No 9/1984.

In the present case the Commission takes the view that when the investment decision was taken (i.e. at the earliest 17 February 1993), CDC-P was aware (or at least should have been aware) of the sharp deterioration of Air France's financial structure. CDC-P certainly knew about the increase in the company's losses for 1992 (FF 3,2 billion in 1992, after FF 685 million in 1991, and FF 717 million in 1990), despite the adoption of the CAP '93 restructuring plan. CDC-P should have been seriously concerned by the critical debt position of the company which, to be redressed, would have required a significant improvement in profitability. Air France's ability to repay its debts from its own cash flows appeared to be weak; Air France's operating profit had not covered interest expenses in the last three years (the interest cover ratio was -0,71 in 1992, 0,10 in 1991, and -0,78 in 1990). Air France's debt levels were very high even for the air transport industry which is highly geared. Air France's debt/equity ratios, despite the major capital expenditure programme under the CAP '93 plan and without taking into account the capitalized operating leases, increased in 1992 in comparison with the previous year.

As regards the internal rates of return of the bonds, it must be recalled that they were calculated by CDC-P taking account of the interest and the implied value of Air France's shares at the time of the conversion. According to the French authorities CDC-P had arrived at its own estimate of the future value of Air France by mid-January 1993. This estimate reflected the assumptions of CDC-P and would certainly have led to lower rates of return if prudent figures had been taken into account. By way of example, the estimate appears to be, at least regarding the ORA, clearly too optimistic because at the time of the issue the highest return forecast by Air France for the ORA was lower than that forecast by CDC-P. Air France included in the prospectus, issued in April 1993, a table setting out the values of Air France's shares at a scale of possible returns on the ORA. The highest return was 13,12 %, which is 0,88 points lower than the return expected by CDC-P (14 %). In the calculation of the internal rate of return for the TSIP-BSA the expected return from the BSA coupon represents an important element. Having regard to the weakness of Air France's financial prospects in the medium and long term, CDC-P would have concluded that the value of the underlying shares was zero. Therefore, the rate of return on the TSIP alone would have been insufficient to justify CDC-P's participation under the market economy investor principle. This conclusion is reinforced when the subordinated nature of the loan is brought into consideration. Therefore, the fact that the internal rate of return of the two bonds, as calculated by CDC-P, was in line with the prevailing market rates is not *per se* sufficiently convincing to exclude the aid character of the operation.

In the light of the deterioration of Air France's financial structure the Commission does not consider that a private investor operating under normal commercial conditions would have been willing to enter into any important financial arrangement with Air France such as that entered by CDC-P.

As regards the market economy investor principle the Court of Justice has stressed that the behaviour of a private investor, with which the intervention of the public investor has to be compared, must at least be that of a private holding company or of a private group which follows a structural, global or sectoral policy and which is guided by profitability prospects in the longer term (1).

In the case of loss-making companies, such a long-term investor would base his decision on a coherent restructuring plan. In the case of Air France the Commission is of the opinion that the aid was not directly linked to the PRE1. Neither the PRE1, the prospectus published in connection with the issue of the two bonds, nor the minutes of the board of directors' meeting, indicate that these investments were aimed at financing the implementation of the plan. Even assuming that the capital injections, by strengthening Air France's own capital, were indirectly linked to the implementation of the PRE1, the Commission has reached the conclusion that the plan was not, even in the long term, sufficient to redress the airline's financial and economic viability. The PRE1 aimed, through the adoption of a number of measures to reduce costs, at improving self-financing capacity by FF 3 billion in 1994 and FF 1,4 billion in 1993. As a consequence of the PRE1, Air France should have significantly improved its results in 1993 and made a profit in 1994. The restructuring measures provided for in the plan concentrated on the reduction of costs, as follows :

- reduction of external expenses (e.g. checking of interline invoicing, renegotiation of airport charges, hotel activity, etc.),
- rationalization of the fleet and the organization (terminating the operation of B 727 aeroplanes, exploiting the synergies of the group, etc.),
- reduction of costs concerning flying personnel and increase in the productivity of ground personnel,
- reduction of costs concerning other personnel,
- reduction in financial costs related to the fleet,

(1) See Case C-305/89, *Italy v. Commission*, [1991] ECR I-1603, paragraph 24, p. I-1641.

- reorganization of the ticket reservation system,
- setting up a hub at Charles de Gaulle airport in Paris from April 1993.

The PRE1 aimed primarily at reducing operating costs and to a minor extent financial charges, but did not sufficiently address the other financial items which were assumed to remain constant. The PRE1 took note of the decrease in unit-yields but, apart from the creation of a hub at Charles de Gaulle airport in Paris, did not contain any other measure to increase revenues. Despite the proximity of the entry into force of the third liberalization package (1 January 1993), the PRE1 did not analyse future market evolution; it assumed, without making reference to any study or statistics, that Air France's long-haul and medium-haul traffic would increase in the four following years by 5 % and 2,5 %, respectively. The PRE1 took note of the temporary overcapacity affecting the air transport industry, but it did not provide for any adaptation of Air France's commercial policy, and on the contrary pursued an investment strategy.

No further restructuring measures were provided for in the PRE1 in case of further deterioration of the economic situation. In this respect the PRE1 stated that: '... any further deterioration in the situation would compromise the attainment of this objective' (improvement in cash flow). 'Air France would therefore embark on a further round of measures to improve its position, which measures cannot be totally excluded at present'. The PRE1 exhibited certain deficiencies in that it envisaged several options without, in certain cases, even definitively selecting one and when an objective was selected failed to indicate the means of achieving it.

In the light of the above considerations, the Commission is of the opinion that the PRE1 was insufficient to redress, even in the longer term, the airline's economic viability and profitability. The Commission considers that at the time of the investment decision CDC-P should have been aware of weak structure of the PRE1. It should also have been aware that Air France, since the adoption of the PRE1 in October 1992, had increased its capacity worldwide beyond the traffic growth (Air France's available seat kilometres increased by 8,2 % in October 1992, while Air France's traffic growth was 4,3 %, 1,8 % and 1,5 % respectively in November, 0,9 % and -1,7 % respectively in December, 3,3 % and 0,7 % respectively in January 1993 and 0 % and -4,1 % respectively in February).

Therefore the Commission is of the opinion that a rational private investor would not have injected FF 1,5 billion into Air France, taking into account its recent poor financial and operating performance, the fact that it had so far been unable to carry out the CAP '93

restructuring programme, and that the PRE1 was manifestly insufficient to redress the situation.

Therefore, the financial injection is an operating aid aimed at helping the national French carrier to temporarily overcome its financial crisis.

3. *The Commission examined whether the aid distorts competition and affects trade.*

Given the strong competition existing on several Community routes operated by Air France, such aid, which strengthens Air France's financial position with regard to its competitors, distorts competition within Europe. The distortion of competition is particularly serious if one takes into account:

- the dimension of Air France, which is one of the largest European carriers and by far the largest French carrier,
- the situation of overcapacity that is, at least temporarily, affecting the European air transport industry and which was particularly acute at the time of the granting of the aid,
- the fact that the aid was granted a few months after the entry into force of the Third Package liberalizing the Community air transport market⁽¹⁾.

The aid affects European trade because it concerns a company which provides transport and whose activity, therefore, by its very nature, directly affects trade and covers the entire Economic European Area.

Therefore, the Commission believes that the subscription by CDC-P to the two bond issues constitutes aid pursuant to Article 92 (1) of the Treaty and Article 61 (1) of the EEA Agreement.

VIII

The aid, which does not fall within the scope of an approved aid scheme, should have been notified to the Commission in accordance with Article 93 (3) of the Treaty. The French Government, by not notifying this aid in advance, i.e. before putting the aid into effect, has failed to fulfil its obligations pursuant to Article 93 (3). The aid has, therefore, been illegally granted and is unlawful.

IX

The Commission cannot consider the aid to Air France as compatible with the common market pursuant Article 92 (2) of the Treaty or Article 61 (2) of the EEA Agreement, since the aid does not fall within any of the cases provided for under these provisions.

⁽¹⁾ Council Regulations (EEC) No 2407/92, (EEC) No 2408/92 and (EEC) No 2409/92, OJ No L 240, 24. 8. 1992, pp. 1, 8 and 15 respectively.

Article 92 (3) of the Treaty and 61 (3) of the EEA Agreement list aid which may be considered compatible with the common market. Such compatibility must be assessed in the context of the Community and not of a single Member State.

Article 92 (3) (a) and (c) of the Treaty and Article 61 (3) (a) and (c) of the EEA Agreement provide for exceptions in respect of aid to promote or facilitate the development of certain regions. The aid to Air France does not seem to qualify for the exemptions laid down in Article 92 (3) (a) or (c), in so far as it relates to regional aids, nor have the French authorities put forward any such arguments in support of the proposed aid.

As for Article 92 (3) (b) of the Treaty and Article 61 (3) (b) of the EEA Agreement, the evidence shows that the aid in question was not intended to promote the execution of an important project of common European interest nor to remedy a serious disturbance in the French economy. Moreover, the French authorities have not invoked this provision.

With regard to the exception under Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement for aid to facilitate the development of certain economic activities, the Commission may consider some restructuring aid as compatible with the common market if it meets a number of conditions⁽¹⁾.

These conditions must be seen in the context of the two principles set out in Article 92 (3) (c) of the Treaty and Article 61 (3) (c) of the EEA Agreement: the aid must be required for developing the activity from the standpoint of the Community and the aid may not adversely affect trading conditions to an extent contrary to the common interest⁽²⁾. These criteria have been interpreted in a sectoral (aviation) context in memorandum No 2 which stipulates that the Commission may in certain cases decide, in accordance with Article 92, that aid may be granted to individual airlines which have serious financial difficulties, provided certain conditions are met:

- (a) the aid must form part of a programme, to be approved by the Commission, to restore the airline's health, so that it can, within a reasonably short period, be expected to operate viably without further aid;
- (b) the aid in question must not transfer the difficulties from that Member State to the rest of the Community;

⁽¹⁾ Eighth report on competition policy, point 176.

⁽²⁾ See the Judgment of the Court of Justice of 17 September 1980 in Case 730/79, *Philip Morris v. Commission*, [1980] ECR 2671.

- (c) any such aid must be structured so that it is transparent and can be verified.

As observed above, the financial injections under scrutiny were not linked to any of the objectives set out in the PRE1, but were operating aids aimed at ensuring the survival of a company experiencing a serious crisis. Even supposing that the funds under scrutiny indirectly formed part of the PRE1, the Commission has demonstrated that this plan was clearly inadequate to restore Air France's health.

X

In the case of aid that is incompatible with the common market, the Commission has the power pursuant to Article 93 (2) of the Treaty, as confirmed by the Court of Justice in its judgment of 12 July 1973⁽³⁾ and in a further judgment of 24 February 1987⁽⁴⁾, to require Member States to compel recipients to repay the aid granted. The French authorities must therefore, within two months, recover the unlawful aid granted to Air France by CDC-P (i.e. FF 1 497 415 290 minus the interest already paid by Air France to CDC-P). The recovery of the aid must take place in accordance with the relevant national provisions, including the provisions on the repayment of interest on arrears in the case of liabilities to the State, interest starting to run with effect from the date of the granting of the aid.

This measure is necessary to re-establish the *status quo* by eliminating all financial advantages from which the recipient of aid illegally granted has unduly benefited since the date of the granting of the aid,

HAS ADOPTED THIS DECISION:

Article 1

The subscription by CDC Participations to the ORA and TSIP-BSA issued by Air France in April 1993 constitutes unlawful State aid amounting to FF 1 497 415 290 since it was granted to the undertaking in breach of Article 93 (3) of the EC Treaty. The aid is incompatible with the common market within the meaning of Article 92 of the EC Treaty and Article 61 of the EEA Agreement.

⁽³⁾ Case 70/72 *Commission v. Germany*, [1973] ECR 813.

⁽⁴⁾ Case 310/85, *Derfil v. Commission*, [1987] ECR 901.

Article 2

France is hereby requested to ensure that the aid of FF 1 497 415 290 is reimbursed within two months of publication of this Decision, deducting, if any, the interest already paid on the bonds, by Air France to CDC-Participations. The recovery of the aid must take place in accordance with the relevant national provisions, including the provisions on the repayment of interest on arrears in the case of liabilities to the State, interest starting to run from the date of the granting of the aid.

Article 3

France shall inform the Commission within two months of the publication of this Decision of the measures it has taken in order to comply with this Decision.

Article 4

This Decision is addressed to the French Republic.

Done at Brussels, 27 July 1994.

For the Commission

Hans VAN DEN BROEK

Member of the Commission
