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Contents

(1) Text with EEA relevance.

EN

Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

The titles of all other acts are printed in bold type and preceded by an asterisk.

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].

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[1] OJ C 49, 19.2.1997, p. 10.

[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 through its specialised subsidiaries. These activities, which were embarked on too rapidly just before the property market fell, and often with insufficient selectivity and risk assessment, resulted in heavy losses. In addition, operating costs, and in particular staff costs, have remained at too high a level, both in absolute terms and individually. In terms of the various productivity ratios (number of staff/net receipts from banking, number of senior staff and executives/total staff, staff costs/staff), SMC is well above the average for banks belonging to the Association Française des Banques (hereinafter: 'AFB').

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 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 leave it in a position incompatible with the prudential and regulatory constraints to which it was subject [4].

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(3) Provisions for real-estate transactions amounted to a total value of FRF 555 million. (This includes FRF 320 million for the building in rue Auber in Paris alone. It should be pointed out that in 1990 a capital gain of FRF 570,5 million on real-estate promotion transactions involving the Paris branch enabled SMC to offset the current losses for the financial year with exceptional income of some FRF 400 million. However, at that time the speculative boom on the property market was at its peak.) Losses on swaps and a capital loss on reclassification of a block of long-term securities amounted to FRF 294 million. To this amount must be added FRF 191 million by way of backdated provisions for long-standing bad debts and FRF 240 million by way of provisions specific to 1994 for loans to SMEs.

(4) The total additional provisions recommended by the independent outside auditor amount to about FRF 2,2 billion, broken down as follows: lending portfolio, FRF 757 million; bad debts, FRF 368 million; subsidiaries, FRF 230; million social liabilities, FRF 416 million; real-estate assets or claims, FRF 227 million; other, FRF 245 million.

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 [5], four were allowed to inspect the documentation [6], 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

(million FRF)

	1992	1993	1994	1995	1996	1997
Overall operating income	1 240	1 353	1 023	977	1 442	1 211
Overheads and depreciation	1 344	1 334	1 262	1 204	1 170	1 158
Gross operating profit or loss	−104	18	−239	−228	272	53
Net profit or loss	−451	−317	−1 257	−952	−22	−3 100
Balance-sheet total	27 587	26 100	26 812	25 634	23 860	23 149
Equity capital	1 106	1 300 [1]	2 147 [1]	1 755 [1]	835	797

(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

(5) 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 Société Générale.

(6) Banque Chaix, Banque Nationale de Paris, Caisse d'Épargne Provence-Alpes-Corse, and Société Générale.

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 specificially 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

Date	Funds provided (million FRF)	Observations
1993 First instalment Second instalment	 460 160	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.
1994 First instalment [1] Second instalment	 95 326	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.
1995 [1]	1 060	Information supplied at the end of April 1995
1996 [1]	858	Information supplied at the beginning of June 1996
1998 [1]	2 909	Information supplied in June 1998
Total at current prices	5 868	

[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 5 868 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 essentially it covers risks which are not identified and hypothetical events internal to SMC.

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 [12]. 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 be interpreted as binding on the shareholders [13]. 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 responsiblity 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, has 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 [14]. 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 [15].

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,

(12) See Articles 179 and 180 of the French Law of 25 January 1985 on company recovery and compulsory winding up, *Journal officiel de la République française*, 26.1.1985.

(13) Judgment delivered on 13 January 1998.

(14) See in particular the Commission Decisions in Bull (OJ L 386, 31.12.1994, p. 1), Crédit Lyonnais (OJ L 308, 21.12.1995, p. 92), and Efim (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 C-280/92 [1994] ECR I-4103).

(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

[16] OJ C 368, 23.12.1994, p. 12.

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

Business plan for SMC submitted by the buyer

(million FRF)

	1997	1998	1999	2000	2001	2002
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 SMC's 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 SMC's '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 6,3033 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 6,3033 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

COMMISSION DECISION

of 14 October 1998

concerning aid granted by Spain to companies in the Magefesa group and their successors

(notified under document number C(1998) 3211)

(Only the Spanish text is authentic)

(Text with EEA relevance)

(1999/509/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 92 and the first subparagraph of Article 93(2) thereof,

Having given notice to interested parties, in accordance with the above provisions, to submit their comments,

Whereas:

I. PROCEDURE

On 16 July 1997 the Commission, after receiving seven complaints in February 1997, decided to initiate the procedure provided for in Article 93(2) of the Treaty in connection with aid received since 1989 by companies in the Magefesa group or the companies which were their successors. (In 1989 the Commission adopted Decision 91/1/EEC [1], in which it found that aid received by the group, which manufactures household goods, was incompatible with the common market.)

On the same date, the Commission asked the Spanish Government for detailed information on the reimbursement of incompatible aid received by companies in the Magefesa group or their successors and on the group's present structure and its legal and financial situation.

In accordance with Article 93(2) of the Treaty, the Commission asked the Spanish Government by letter of 6 August 1997 to submit its comments within a month. The other Member States and third parties were informed in the *Official Journal of the European Communities* [2] of the decision to initiate the procedure provided for in Article 93(2) of the Treaty, and were invited to submit their comments.

The Spanish authorities responded by letter of 12 November 1997 to the initiation of the procedure, providing comments and information.

[1] OJ L 5, 8.1.1991, p. 18.
[2] OJ C 330, 1.11.1997, p. 2.

Two competitors and the trade unions of the company Industrias Domésticas SA (Indosa) submitted their comments by letters dated 28 November 1997. These were passed on to the Spanish authorities for their comments by letters dated 17 and 23 December 1997 and 9 January 1998. The Spanish authorities did not submit comments.

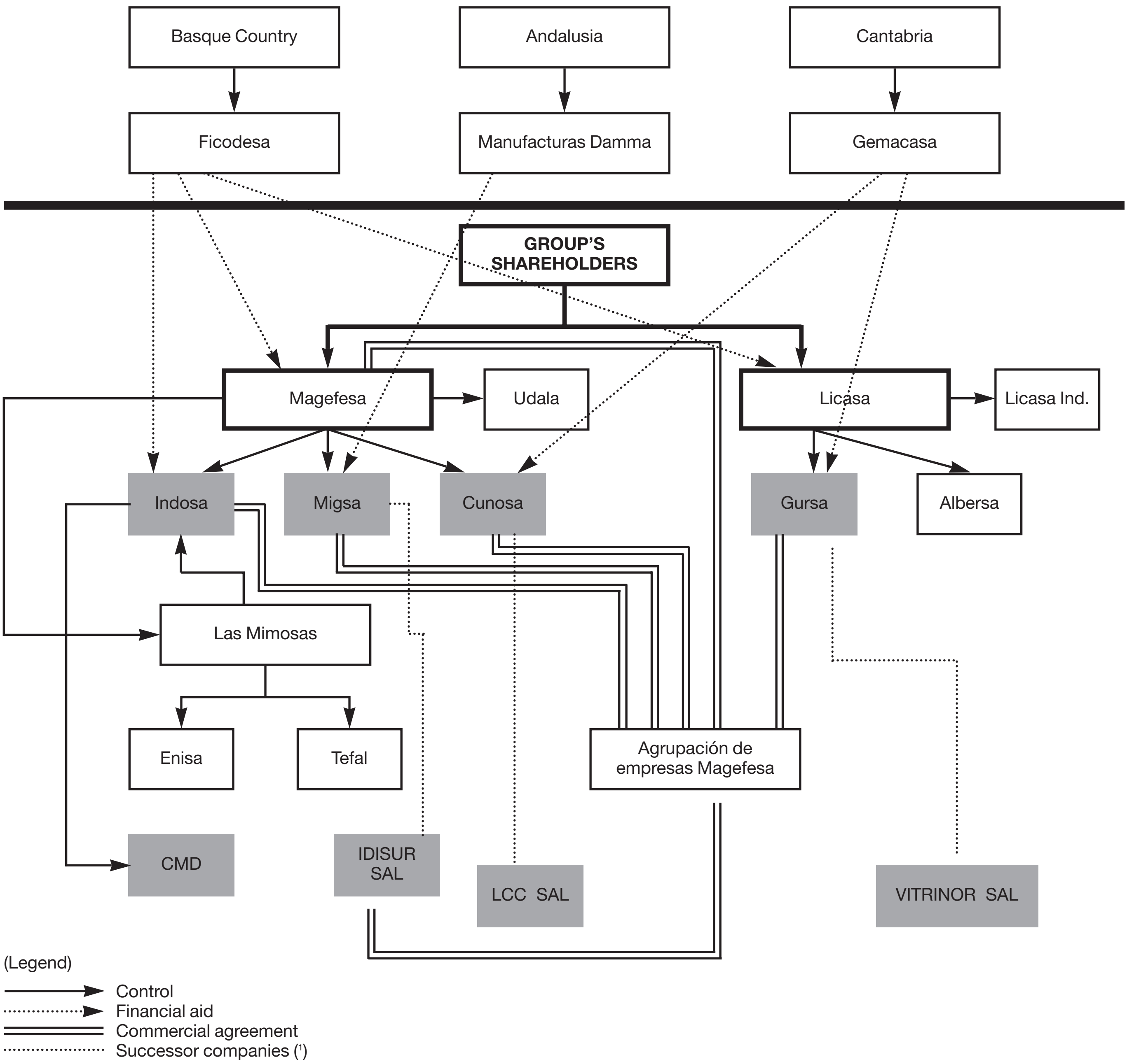
The receiver responsible for Indosa, one of the companies which received aid declared incompatible in 1989 and more recent aid, submitted its comments by letter of 27 November 1997. The substance of these comments was incorporated as an annex in the Spanish Government's abovementioned letter of 24 April 1998.

As the Commission took the view that some issues remained which had not been clarified by the Spanish authorities' response to the initiation of the procedure, the latter were sent a further request for information by letter of 24 February 1998. With the abovementioned letter of 24 April 1998, the Spanish authorities provided a complex document including numerous annexes in support of the information supplied.

II. STRUCTURE OF THE GROUP

The Magefesa group [3] and its successors manufacture household goods such as pressure cookers, saucepans and stainless steel cutlery. The group's structure may be represented as follows:

[3] — Grupo Magefesa includes the main company, Manufacturas Generales de Ferretería (hereinafter referred to as 'Magefesa'), the industrial companies Cuberta del Norte SA (Cunosa), Manufacturas Inoxidables Gibraltar SA (Migsa), Indosa, Investigación y Dessarrollo Udala SA and Las Mimosas SA (Inlamisa), through which Magefesa holds a stake in Edificios y Naves Industriales, SA (Enisa) and Tefal Española SA;
— Grupo Licasa, which includes La Industrial Cuchillería Alavesa SA, Licasa Patrimonial SA Manufacturas Gur SA (Gursa), Alberdi Hermanos SA (Albersa) and Licasa Industrial SA;
— similarly, various companies within the group (Magefesa, Cunosa, Gursa, Migsa, Indosa) formed a commercial group, Agrupación de Empresas 'Magefesa', through which they bought their raw materials and marketed their products.



Note

(1) For the purposes of the present Decision, 'successor companies' means (without this having legal implications) an economic entity in which companies set up by former Migsa, Cunosa and Gursa workers continue working in the same plants, using the same machinery and manufacturing products with the same trade mark as their predecessors.

In December 1985 three intermediary companies were set up by the authorities of the autonomous communities in whose territory the manufacturing companies of the Magefesa group were based, the aim being to provide channels for the aid which was later declared incompatible (in 1989):

— Manufacturas Damma, SA (Manufacturas Damma), based in Andalusia and controlled by the authorities of the Autonomous Community of Andalusia,

— Gestión de Magefesa en Cantabria, SA (Gemacasa), based in Cantabria and controlled by the authorities of the Autonomous Community of Cantabria,

— Fiducias de la cocina y derivados, SA (Ficodesa) in the Basque Country, a private company, though subject to control by the authorities of the Basque Autonomous Community through *ad hoc* agreements.

These companies controlled the use of aid and the implementation of the 'action programme' while at the same time ensuring the continued operation of the Magefesa companies by preventing creditors from enforcing their claims through seizure of the companies' financial resources and stocks of goods. On the basis of agreements, they thus marketed all products manufactured by Magefesa after acquiring them from each of the companies; at the same time they administered the funds, raw material and semi-finished products needed by the industrial companies.

When the complaints were received in 1997, some of the group's companies had been declared bankrupt (Magefesa, Indosa and Cunosa), while others were not active (Migsa and Cursa). In November 1994 the receiver responsible for Indosa set up Indosa Derio, SL, now known as Compania de Menaje Doméstico, SL (CMD) in order to provide an outlet for Indosa's products. Until 1993, the four manufacturing companies in the Magefesa group (Indosa, Migsa, Cunosa and Gursa) employed over 800 workers.

Indosa now has 330 workers and its turnover for 1997 was approximately ESP 3 000 million. The only industrial company in the group which is still active, it manufactures chiefly pressure cookers and saucepans.

A number of workers formerly employed by Cunosa (now bankrupt) and Migsa and Gursa (not active) set up the Companía de Cubiertos, SAL (LCC), Idisur, SAL (Idisur) and Vitrinor, SAL (Vitrinor) [4].

The Agrupación de Empresas Magefesa was dissolved on 29 October 1996.

As regards the intermediary companies, Ficodesa was declared bankrupt in 1995 and Gemacasa and Manufacturas Damma are not active.

III. **AID**

The Commission decided to initiate the procedure provided for by Article 93(2) of the Treaty in respect of the following:

— non-payment of taxes and social contributions by the Magefesa group and its successors,

— Indosa's continued manufacturing activities, despite having been declared bankrupt in 1994, and its failure to fulfil its tax and social security obligations,

— the Basque Government's intention to grant Indosa an ESP 804 million guarantee to back a bridging loan for the period until Indosa received the expected payments from the salary guarantee fund (Fogasa) [5] and the Ministry of Labour,

— payments actually made by Fogasa and the Ministry of Labour to the companies of the Magefesa group, or which they planned to make.

As mentioned above, the presumed failure to recover incompatible aid dating back to 1989 was also taken into consideration when the Commission decided to initiate the procedure provided for in Article 93(2) of the Treaty; it then stated that it would consider the compatibility of any aid granted in view of what had happened to the recovery of the following aid, declared incompatible by Decision 91/1/EEC:

— *a loan subject to conditions different from those obtaining on the market* to the value of ESP 2 085 million, granted by Fogasa for the payment of compensation to workers dismissed as a consequence of the 'action programme',

— *loan guarantees* totalling ESP 1 580 (ESP 972 million from the Basque Government, ESP 512 million from the Government of the Autonomous Community of Cantabria and ESP 96 million from the Andalusian Government) [6],

— *non-refundable grants* totalling ESP 1 094 million (ESP 803 million from the Basque Government, ESP 262 million from the Government of the Autonomous Community of Cantabria and ESP 29 million [7] from the Andalusian Government [8],

[4] SAL is the acronym of *sociedad anónima laboral*, a limited company set up by the workers themselves. LCC, Idisur and Vitrinor were set up on 9 June 1994, 22 April 1993 and 27 March 1995 respectively. Idisur concluded a commercial agreement with the Agrupación de Empresas Magefesa on 1 October 1993.

[5] Regulated by Royal Decree 505/1985 of 6 March 1985.

[6] Loan guarantees: (i) ESP 972 million granted by the Basque Government on the basis of two decisions taken in connection with Decree 150/1985 of 11 June 1985, as follows: guarantee of ESP 300 million granted on 21 January 1986 directly to Indosa; and guarantee of ESP 672 million, granted on 3 June 1986 to Ficodesa for use by the companies of the Magefesa and Licasa subgroups based in the Basque Country; (ii) guarantee of ESP 512 million, granted by the authorities of the Autonomous Community of Cantabria in March 1986 to Gemecasa, for use by Cunosa and Gursa; (iii) guarantees totalling ESP 96 million, granted by the *Sociedad para la Promoción y Reconversión Industrial de Andalucía* (Soprea, today known as the *Instituto de Fomento de Andalucía*) to Manufacturas Damma on 14 February 1986 and 5 February 1987 for use by Migsa.

[7] The sum of ESP 39 million, referred to in Decision 91/1/EEC and in the decision to initiate this procedure, has been corrected on the basis of documents submitted by the Spanish authorities.

[8] Grants: (i) grant of ESP 803 million awarded by the Basque Government on 3 June 1986 to Ficodesa 'for deployment' within the companies of the subgroups Magefesa and Licasa, based in the Basque Country, on the basis of decisions adopted under Decree 150/1985 of 11 June; (ii) grant of ESP 262 million awarded by the Autonomous Community of Cantabria in October 1986 to Gemacasa, for deployment within Cunosa and Gursa; (iii) grant of ESP 29 million awarded by the authorities of the Autonomous Community of Andalusia to Manufacturas Damma on 29 May 1987 under Decree 93/1987, with a view to supporting the social measures underpinning the relaunch of Migsa.

— *subsidisation of interest payable on loans*, totalling ESP 9 million.

The Spanish Government was asked to recover the incompatible aid granted by Fogasa and the Governments of the Autonomous Communities of the Basque Country, Cantabria and Andalusia by the following means:

— the *loan subject to conditions different from those obtaining on the market* to the value of ESP 2 085 million, granted by Fogasa, was to be converted into loans subject to market conditions or be terminated; alternatively, some other measure was to be taken which would ensure complete elimination of the aid component,

— the *loan guarantees* totalling ESP 1 580 million were to be terminated,

— the *grants* totalling ESP 1 094 were to be recovered.

IV. COMMENTS BY INTERESTED PARTIES

The following comments were received from interested third parties:

— a competitor pointed out that Vitrinor, the workers' cooperative set up by a number of workers formerly employed by Gursa, was using Gursa's plant free of charge,

— another competitor pointed out that: (i) the incompatible aid had not been repaid; (ii) Indosa had not paid taxes or social contributions since the adoption of Decision 91/1/EEC; (iii) Magefesa's products were being sold at prices 33% below those of its competitors; (iv) the receivers, appointed by the national authorities and the authorities of the autonomous communities concerned, had allowed all this to take place,

— the trade union representatives indicated that Fogasa had intervened on behalf of the workers, not the company. They also informed the Commission that the workers had set up a pension fund using their own resources.

The receiver responsible for Indosa, one of the companies which had received both aid declared incompatible in 1989 and fresh aid, submitted its comments by letter of 27 November 1997. The substance of these comments was incorporated in the form of an annex to the letter of 24 April 1998 from the Spanish Government, referred to in section VI.

V. SPAIN'S RESPONSE TO THE INITIATION OF THE PROCEDURE

(a) Recovery of aid declared incompatible in 1989

As regards the recovery of the aid declared incompatible by Decision 91/1/EEC, the situation may be summarised as follows:

It was decided in 1990 to convert the *loan subject to conditions different from those obtaining on the market*, which amounted to ESP 2 085 million, into a loan subject to market conditions. However, since the companies failed to respect the terms of the loan [9], Fogasa again had recourse to enforced collection, giving rise to the seizure of the trade marks of the Magefesa group.

As regards the *loan guarantees* to the total value of ESP 1 580 million and the *non-refundable grants* totalling ESP 1 104 million, made available by the Governments of the Autonomous Communities of the Basque Country, Cantabria and Andalusia, the Council of State — Spain's supreme consultative body — was consulted in 1990 as to how Spain should implement Decision 91/1/EEC.

As regards the *loan guarantees*, the Council of State ruled that the Governments of the Autonomous Communities concerned had to put the guarantees into effect immediately and then recover the sums concerned from the beneficiaries; as for the *non-refundable grants*, the Government of the Autonomous Communities had to revoke the decisions awarding them, after which they were to recover the sums already paid.

The Governments of the Autonomous Communities took the following action:

— *Basque Government*: the *loan guarantees* were put into effect immediately as recommended by the Council of State, but between 1989 and 1993, to the value of ESP 1 365 717 623 (including principal and interest). Following a fruitless request for reimbursement, a demand for enforced reimbursement was made, which did not produce any results either. The Basque Government decided to declare null and void the decision to award the *non-refundable grants*, taken in March 1994, that is, more

[9] As explained under (b) of this section, loans subject to conditions different from those applying on the market were granted within the framework of a 'refund agreement', under which Fogasa, having been surrogated by law to the workers' rights with respect to the debtor companies, and on the basis of the applicable legislation, decided not to initiate enforcement procedures immediately, but to conclude a 'refund agreement'. As the 'refund agreement' was not respected, Fogasa remained at liberty to continue with enforced recovery.

than four years after the notification of Decision 91/1/EEC. A demand for payment was sent to Ficodesa on 25 January 1995, by which time the company had already been declared bankrupt (on 19 January 1995).

Both types of claim *(loan guarantees and grants)* were included in the list of Ficodesa's creditors. The Spanish authorities have not informed the Commission of the ranking of these claims. Since they are public claims, they should have the same degree of preference as that extended to other public claims under the Spanish legal system,

— *Government of the Autonomous Community of Andalusia:* having put into effect the loan guarantee of ESP 96 million and after demanding, unsuccessfully, that Manufacturas Damma pay the guaranteed sum, the Instituto de Fomento de Andalucía (Institution for the Promotion of Andalusia, IFA), the owner of Manufacturas Damma, declared the said loan guarantee irrecoverable on 17 June 1993. As regards the *non-refundable grants* to the value of ESP 29 million, the authorities of the Autonomous Community of Andalusia stated that although the procedure to cancel the decision awarding the grant had begun on 21 November 1990, the recovery procedure had not been carried forward because Manufacturas Damma had no assets which were free of charges,

— *Government of the Autonomous Community of Cantabria:* the *loan guarantees* were not put into effect immediately, as recommended by the Council of State, but during the period 1994-95. The Spanish authorities have not provided any detailed information on the refund of grants; rather, they have confined themselves to pointing out that Cunosa and Gursa had no assets free of charges and that any measures taken by Gemacasa to recover aid would therefore have been fruitless. They have not explained why Gemacasa or the Government of the Autonomous Community did not include the incompatible aid granted to Cunosa in the list of the latter's creditors.

(b) New aid granted after adoption of Decision 91/1/EEC

Payments made by Fogasa and the Ministry of Labour and Social Affairs

The Spanish authorities have stated that in the event of insolvency or bankruptcy of an employer, it is Fogasa which pays compensation to workers, and is thus subrogated by law to their rights, for the amounts legally established only. This means that Fogasa can initiate or pursue enforced collection procedures against the company to recover the sums it has paid to workers. Fogasa can choose not to have immediate recourse to the enforced collection procedure and instead to conclude a 'refund agreement', the signing of which entails suspension of legal collection measures. According to the Spanish authorities, this is the case particularly when the said payments have been made to workers after examination of each case to establish that the workers are indeed entitled to them. The conclusion of refund agreements is decided on a case-by-case basis. The decision to conclude them must combine 'the efficacy of the subrogatory measure with the requirements of business continuity and employment safeguards' (Section 32 of Royal Decree 505/1985). The methods and conditions for the conclusion of such agreements are laid down by Ministerial Order of 20 August 1985.

According to the information supplied by the Spanish authorities, Fogasa and the Magefesa group have not concluded refund agreements of the type declared incompatible by Decision 91/1/EEC, which laid down refund terms different from those obtaining on the market.

As for the special grants awarded by the Ministry of Labour and Social Affairs to Indosa workers whose employment contracts had been terminated, the Spanish authorities stated that a total of ESP 437 571 733 was paid on 5 March 1997 to 120 Indosa workers, to guarantee them more appropriate unemployment cover and pension rights after the termination of their contract with Indosa.

Persistent non-payment of taxes and social security contributions

The Spanish authorities have detailed the amount of tax owed to the National Treasury and the social security contributions which have remained unpaid since 1989, both before and after Indosa, Cunosa and Magefesa were declared bankrupt. No figures have been supplied on the taxes owed to the Vizcaya Regional Treasury for the period after Indosa was declared bankrupt. As for Gursa and Migsa, which have now stopped operating, a summary has been provided of the measures adopted by the National Treasury and the Social Security with regard to the sums owed. It has also been explained why Vitrinor and Idisur were not declared responsible for the debts incurred by Gursa and Migsa respectively, as their successors: the new companies were legally independent of their predecessors and had been set up by the workers after the termination of their employment contracts.

Aid granted to other companies

The regional authorities of Andalusia provided information on the regional aid received by Idisur.

VI. ADDITIONAL INFORMATION REQUESTED IN THE COURSE OF THE PROCEDURE AND THE REPLY FROM THE SPANISH AUTHORITIES

By letter of 24 February 1998, the Commission requested further detailed information on the following matters:

— it requested a list of the creditors of the companies declared bankrupt (Magefesa, Indosa and Cunosa), including the sum involved and the relative priority of the claim,

— it asked why, if the non-active companies (Migsa and Gursa) were insolvent, the administration had not initiated bankruptcy proceedings, like any diligent creditor. It also requested information on the conditions under which the assets of the said companies had been transferred to the new companies set up by the workers (Idisur and Vitrinor),

— as regards Indosa's 'bankruptcy followed by continued activity', the Commission asked why the receivers, two of whom had been appointed on a proposal from the Social Security and the Vizcaya Regional Treasury, had allowed Indosa to continue operating after the declaration of bankruptcy. It requested copies of any judicial decision or creditors' agreement which might legitimise this situation. It also requested information on the debt contracted with the National Treasury, the Regional Treasury and the Social Security following the bankruptcy declaration,

— the Spanish authorities were asked to provide information about any aid granted to Vitrinor and Idisur, which were set up by former workers using the assets of Gursa and Migsa respectively.

By letter of 24 April 1998, the Spanish authorities submitted a complex document including numerous annexes to back up the information provided.

(a) Recovery of aid declared incompatible in 1989

The Governing Councils of the Autonomous Communities of Andalusia and Cantabria considered that the aid declared incompatible should be repaid by the intermediary companies through which it was channelled, i.e. Manufacturas Damma (Andalusia) and Gemacasa (Cantabria), since — formally speaking — it was they which had received the grants and benefited by the guarantees. According to the Spanish authorities, during the implementation of the action programme Gemacasa became a creditor of Cunosa and Gursa. The latter companies owed Gemacasa unspecified sums which, given their critical situation, were never repaid. The Spanish authorities confirmed that Manufacturas Damma, a creditor of Migsa, was sold to Migsa for the symbolic price of one peseta in June 1993, which meant that no further action was taken to recover the incompatible aid. The authorities of the Autonomous Community of Andalusia stated that no measures were taken to have Manufacturas Damma declared bankrupt because it was felt that it would be imprudent for the company's sole shareholder to take such action.

No further information was provided about the aid granted by the authorities of the Basque Autonomous Community.

(b) New aid granted after adoption of Decision 91/1/EEC

Payments made by Fogasa and the Ministry of Labour and Social Affairs

The Spanish authorities submitted a list of the sums paid by Fogasa to the workers of Indosa, Gunosa, Migsa and Gursa, as well as confirmation of the payments made by the ministry of Labour to Indosa's workers. This information shows that Fogasa approved the following payments over the 1989-1998 period:

	(ESP)
Indosa	416 455 625
Gursa	612 972 521
Cunosa	81 813 513
Migsa	198 413 068

As regards the complaints about the fact that Indosa had asked Fogasa and the Ministry of Labour and Social Affairs for new aid and that the Basque Government planned to grant an ESP 1 000 million guarantee for a bridging loan until such time as the new aid arrived, the Spanish authorities have confirmed that Indosa asked the Basque authorities in September 1996 for aid to cover the dismissal of 120 workers through early retirement. As a consequence of the decision to initiate the procedure provided for in Article 93(2) of the Treaty, in which decision the Commission reminded the Spanish authorities of the suspensory effect of Article 93(3), the Basque Government decided not to grant the guarantee of ESP 804 million.

As regards the intervention of the Ministry of Labour and Social Affairs on 9 August 1996, the Basque Government authorised the termination of 120 employment contracts with Indosa staff. On 18 November 1996 the Ministry of Labour granted exceptional aid in order to augment unemployment benefit and the base for pension contributions. This measure was based on a Ministerial Order of 5 April 1995 on social emergencies involving workers. The purpose of the measure was to allow workers: (i) to benefit from the highest possible level of unemployment protection throughout the 24 months following the termination of their contracts; and (ii) to obtain early retirement under better financial conditions. On 5 March

1997, ESP 437 471 733 was paid to Indosa workers whose employment contracts had been terminated. The Spanish authorities stressed that the payment of this sum was in the interests of a number of workers who were particularly at risk.

Persistent non-payment of taxes and social security contributions

Lists of Indosa's and Cunosa's creditors were submitted, along with the totals of unpaid taxes and social security contributions. The latter were as follows.

Amounts owed by bankrupt companies

(ESP million)

	Social Security	NationalTreasury	RegionalTreasury
Indosa [1]	4 602	210	1 898
Cunosa	1 772	790	—

[1] The next section deals with the issue of Indosa's debt under this heading which has arisen since the declaration of bankruptcy.

Total amount: ESP9 272 million.

The taxes and social security contributions which have not yet been paid by the non-active companies (Migsa and Gursa) are as follows.

Amounts owed by non-active companies

(ESP million)

	Social Security	National Treasury
Migsa	586	No data available [1]
Gursa	2 767	525

[1] This amount does not include the debt contracted by Migsa with the National Treasury. According to the letter from the Spanish authorities of 12 November 1997, the Sistema Informático de Recaudación ('computerised collection system') does not register the sums owed because it has been decided to declare these debts irrecoverable.

Total amount for the 'non-active' companies: ESP 3 878 million.

The total for all bankrupt or non-active companies is ESP 13 150 million, or ECU 78,82 million [10].

The Spanish authorities stated that they had not called for Migsa and Gursa to be declared bankrupt, as any diligent creditor would have done, because the procedures preceding the declaration of bankruptcy were lengthy and costly and it was their practice not to take action on purely formal grounds, but only when there was a real possibility of recovering the funds concerned. They had, at any rate, applied the enforced collection procedure of seizure to Migsa and Gursa, but it had proved unsuccessful because neither had any assets free of charges.

The Spanish authorities also provided information about the seizure procedures applied to Indosa and Cunosa before they were declared bankrupt at their employees' instigation.

As regards the way in which Idisur and Vitrinor were established, the Spanish authorities stated that Migsa and Gursa were still the owners of the plants concerned, which had been leased to new companies, these having been set up by a number of former employees.

Persistent non-payment of taxes and social security contributions after Indosa's declaration of bankruptcy

The declaration of bankruptcy includes the following claims by public bodies:

(ESP)

Social Security	4 602 668 983
Regional Treasury	1 596 191 052
Fogasa	413 935 458
National Treasury	134 102 630
Basque Government	2 800 200
Total	6 749 698 323

The total sum, equivalent to ECU 40,17 million, represents over half of the claims recognised in the context of Indosa's bankruptcy procedure [11]. The Spanish authorities have supplied no information on the relative priority of these claims.

In the course of the proceeding under Article 93(2) of the Treaty, the Spanish Government has not submitted any copies of a judicial decision establishing bankruptcy in combination with continued activity. However, the Spanish authorities have submitted the document issued by the meeting of Indosa's creditors on 30 January 1995, which did confirm this.

Although the application for the declaration of bankruptcy explicitly called on the court to rule that Indosa should continue its industrial activity, the court did not give any ruling on this matter in its decision of 19 July 1994 declaring

[10] The sums are given in ecu for illustrative purposes only (ECU 1 = ESP 166,822).

[11] The total sum is ESP 12 439 688 347, which is equivalent to ECU 74,56 million. This sum does not include the aid to Indosa which was declared incompatible in 1989.

Indosa bankrupt. Six months later, on 30 January 1995, a meeting of creditors was called in order to appoint the receivers in bankruptcy. The main creditors (the Social Security and Vizcaya Regional Treasury) proposed two of the three receivers to be appointed under Spanish law. The remaining creditors proposed the third. All three were accepted after a vote. The legal representative of the instigator of bankruptcy then asked the creditors to give their views on the fact that industrial activity was continuing. According to the record of the meeting, only Fogasa and the Municipality of Derio [12] said they were in favour of continued activity. No opposing views were expressed. The record of the meeting contains no evidence of any opposition by the Social Security, the national authorities or the authorities of the Autonomous Community, which, given the scale of their claims, had sufficient votes to block approval of Indosa's continued activity.

During the period between the declaration of bankruptcy (19 July 1994) and April 1997, unpaid social contributions rose to ESP 1 282 117 590. Although the Spanish authorities have been requested to inform the Commission of the tax debt run up during this period with the Vizcaya Regional Treasury, they have not done so.

The Spanish authorities have confirmed that Indosa has kept up to date with its tax and social security obligations since May 1997.

Aid granted to other companies

As regards the granting of other aid, the Spanish authorities have confirmed that Vitrinor did not receive any aid and also supplied an updated list of public measures benefiting Idisur.

In view of the special nature of the Idisur case, in which aid has presumably been granted, at least in part, in the context of regional aid schemes approved by the Commission, this matter is not covered by the present Decision and will therefore be dealt with in the appropriate manner in due course.

VII. **LEGAL ASSESSMENT**

Article 92(1) of the Treaty lays down the principle that, save as otherwise provided in the Treaty, any aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

The products marketed by the companies of the Magefesa group are traded between the Member States and there is competition between manufacturers. Moreover, the Magefesa group operated on Community markets in the past and was one of Spain's main manufacturers in the sector concerned.

According to a 'viability plan' presented by Indosa in early 1996, Magefesa's products accounted in 1990 for 39 % of the Spanish market in pressure cookers and 37 % of the market in saucepans. In 1994, the market shares of these products were 23 % and 13 % respectively.

In the years before the declaration of bankruptcy or the interruption in the activities of the companies concerned, intra-Community trade in stainless steel kitchenware and household goods (excluding those for use at table) and stainless steel cutlery (CN codes 7323 93 90, and 8215 20 10) amounted in 1990 to ECU 251,6 million and ECU 38,6 million respectively, and in 1992 to ECU 281,6 and ECU 38,9 million respectively. Spain declared that its trade with the other Member States accounted for the following sums: in 1990, ECU 17,9 million and ECU 3,2 million respectively, and in 1992, ECU 17,7 million and ECU 2,6 million respectively.

After Indosa was declared bankrupt in 1994, intra-Community trade in stainless steel kitchenware and household goods (excluding those for use at table) (CN code 7323 93 90 amounted to ECU 181,3 million. In the same year Spain declared that its trade with the other Member States accounted for ECU 16,7 million. In 1997, intra-Community trade in these products rose to ECU 230,6 million. In the same year, Spain declared that its trade with the other Member States accounted for ECU 17,5 million.

Article 92(1) of the Treaty states that any aid of the nature described in that paragraph is, in principle, incompatible with the common market. Article 92(3) of the Treaty lists the types of aid which may be considered compatible with the common market. Compatibility with the common market must be established in the context of the Community as a whole, not in that of a single Member State. In order to ensure the proper functioning of the common market, and bearing in mind the objective laid down under Article 3(g) of the Treaty, the exceptions listed in Article 92(3) of the Treaty must be interpreted strictly when examining aid schemes or authorising an individual aid measure.

To be precise, these exceptions can be relied on only when the Commission concludes that, if no aid were granted, market forces alone would not suffice to guide the beneficiaries towards patterns of behaviour conducive to any of the objectives referred to in Article 92(3). Making such exceptions in cases which do not further these objectives or in which aid is not necessary to achieve this aim would entail granting advantages to the industries or companies of certain Member States which would strengthen them financially, thereby adversely affecting trading conditions between the Member States and distorting competition without any justification on any of the common interest grounds listed in Article 92(3) of the Treaty.

(a) **Recovery of aid declared incompatible in 1989**

As was stated at the start of the procedure, it is appropriate to look at the recovery of the aid declared incompatible by

[12] Derio (Vizcaya) is the municipality where Indosa is based.

Decision 91/1/EEC when examining the new aid granted to the same companies. In accordance with the decision of the Court of Justice of the European Communities of 15 May 1997 in Case C-355/95 P, *Textilwerke Deggendorf v. Commission and Germany* [13], it is the Commission's responsibility, when examining new aid, to assess the cumulative effect in terms of distortion of the market of new aid and unrecovered incompatible aid.

As regards the loan of ESP 2 085 million granted by Fogasa under conditions different from those obtaining on the market, it was decided in 1990 to convert it into one based on market conditions. However, when the companies failed to respect the terms under which the loan had been granted, Fogasa again started enforced collection procedures, which resulted in the seizure of the trade marks of the Magefesa group; enforced collection procedures are currently still in progress.

As for the loan guarantees totalling ESP 1 580 million and the non-refundable grants totalling ESP 1 104 million awarded by the Governments of the Autonomous Communities of the Basque Country, Cantabria and Andalusia, the information provided by the Spanish authorities leads to the following conclusions:

— *Government of the Basque Autonomous Community:* the first guarantee, to the value of ESP 300 million, was granted to Indosa on 21 January 1996. The second, to the value of ESP 672 million, was granted to Ficodesa on 3 June 1986 for use by Indosa and the other companies of the Magefesa group based in the Basque Country. Without these two guarantees, Indosa and the other companies would have been forced to stop operating, because their situation was such that they could not take out loans in order to stay in business. As for the grants to the value of ESP 803 million, it should be recalled that they were awarded to enable the Magefesa group to pay the part of the wages and compensation which Fogasa had not advanced to the workers, because the sum involved exceeded its overall maximum limits. Moreover, the aim was to reduce costs for Indosa and the other companies, not for Ficodesa. In the Commission's view, its Decision 91/1/EEC cannot be considered to have been implemented merely because the sum of ESP 2 168 717 623 has been included in the list of Ficodesa's creditors. Firstly, it should be pointed out that the authorities of the Autonomous Community acted slowly when withdrawing the loan guarantees and recovering the grants. Secondly, by including the two loans only in the list of Ficodesa's creditors and not in Indosa's or those of the other companies of the Magefesa group based in the Basque Country, the authorities of the Basque Autonomous Community have acted as though Ficodesa were the sole beneficiary of the incompatible aid and it were up to Ficodesa alone to pay it back. The reality was very different, as Ficodesa was only an intermediary company with no productive capacity of its own, set up for the sole purpose of channelling the financial aid granted by the Government of the Basque Autonomous Community to Indosa and the other companies of the Magefesa group based in the Basque Country.

The above shows that the incompatible aid granted by the Basque Government has not been duly recovered, as the companies which received aid have not been required to repay it,

— *Government of the Autonomous Community of Andalusia:* Manufacturas Damma was only an intermediary without any manufacturing activity, set up for the sole purpose of channelling the financial aid granted by the Government of Andalusia to Migsa, the industrial company belonging to the Magefesa holding company and based in Andalusia. The non-refundable grants, totalling ESP 29 million, enabled Migsa to pay the share of wages and compensation which it owed the dismissed workers. In other words, it was Migsa, not Manufacturas Damma, which benefited from reduced expenses. Moreover, Migsa would have been forced to stop operating if it had not benefited from loan guarantees totalling ESP 96 million, as its situation prevented it from obtaining loans to continue operating. The Commission does not believe that the measures taken by the Government of Andalusia comply fully with its Decision 91/1/EEC. Neither does it share the Spanish Governments's view that the incompatible aid was granted to Manufacturas Damma rather than Migsa and that it is therefore the latter which should be called on to repay the aid.

The above shows that the incompatible aid granted by the Government of Andalusia has not been duly recovered, since the company which benefited has not been required to pay back the aid,

— *Government of the Autonomous Community of Cantabria:* for the same reasons as with the Basque and Andalusian authorities, the incompatible aid granted by the Autonomous Community of Cantabria appears not to have been duly recovered, since the beneficiaries have not been required to pay back the aid.

In the light of the Deggendorf case, it was appropriate to look at the recovery of the aid declared incompatible by Decision 91/1/EEC before examining the new aid granted to the same companies.

(b) **New aid granted after the adoption of Decision 91/1/EEC**

Payments made by Fogasa to the workers of Indosa, Cunosa, Migsa and Gursa between 1989 and 1998 and by the Ministry of Labour and Social Affairs to Indosa workers

Fogasa's payments were made on the basis of a subrogation by law to the rights of the insolvent company's employees. Fogasa's measures are universally and automatically applicable, without sectoral restrictions, to any worker who meets the requirements laid down in the regulations. Moreover,

[13] [1997] ECR I–2549.

according to the information provided by the Spanish authorities, Fogasa and the Magefesa group have not concluded 'refund agreements' like that declared incompatible by Decision 91/1/EEC, which established loan conditions different from those applicable on the market.

According to the information available to the Commission, the special grants made by the Ministry of Labour to workers who had lost their jobs constituted a public measure to guarantee those workers a better level of unemployment benefit. Moreover, this exceptional decision was taken after the termination of the employment contracts of the Indosa workers concerned and as a result they received social benefits topping up the benefits which the company was legally obliged to pay out. It cannot be argued that this measure benefited the company itself and it does not, therefore, constitute aid to Indosa, but rather exceptional aid with an essentially positive impact on the social situation of the workers concerned.

The Commission's investigation has not, therefore, established the existence of an aid component in the above measures.

Persistent non-payment of taxes and social security contributions

According to information supplied by the Spanish authorities, the companies in the Magefesa group have systematically failed to meet their tax and social security obligations since 1989 (as they did prior to that date), despite any forced recovery procedures which may have been initiated or instigated by the administration (seizures and payment orders).

It was only on the initiative of the workers themselves that Indosa and Cunosa were declared bankrupt. The sums owed to public creditors were included in the list of Magefesa's, Indosa's and Cunosa's creditors because this is the proper procedure under Spanish national law to ensure that the Social Security and the national and regional Treasuries retain the possibility of recovering at least a proportion of their claims. Cunosa is currently undergoing liquidation. The Spanish authorities have submitted written evidence showing that CMD (a branch of Indosa) and LCC (Cunosa's successor) were up to date with their tax and social security payments.

The national Treasury and the Social Security declared their claims on Migsa and Gursa irrecoverable, with the exception of Gursa's debts towards the national Treasury. No bankruptcy proceedings were instituted against either of the two companies. New companies were set up by a number of the former employees of Migsa and Gursa: Idisur (22 April 1993) and Vitrinor (27 March 1995) respectively. The new companies signed agreements with their predecessors on the use of their machinery and plant. The Spanish authorities have demonstrated that Idisur and Vitrinor are up to date with payments to the national Treasury and the Social Security.

The Spanish authorities explain that bankruptcy proceedings were not initiated because the costs incurred would have exceeded the estimated sums potentially obtainable by auctioning off the debtor's assets. In such cases the decision to initiate bankruptcy proceedings requires an analysis of the cost in each individual case. This analysis revealed here, according to the Spanish authorities, that it was more cost effective to declare the claims of public creditors irrecoverable than to initiate bankruptcy proceedings. Apart from this general statement, however, they have not presented any comparative analyses setting out the costs of the various options. Moreover, even if a cost analysis showed that there were a comparative advantage in not initiating bankruptcy proceedings, the fact remains that, in a situation like that described by the Spanish authorities in which the absence of assets not free of charges renders any forced recovery procedure (seizure, payment orders, etc.) ineffective, the non-initiation of bankruptcy proceedings has enabled the companies in question — unlike their competitors — to continue operating without meeting their tax and social security obligations, all this despite their extremely precarious position. The huge sums of unpaid taxes and social security contributions resulting precisely from the continued activity of the companies concerned undoubtedly exceed the cost of a bankruptcy procedure.

The Commission has also investigated whether the public creditors behaved in the way they did with a view to maximising their chances of recovering unpaid taxes and social security contributions. The Spanish authorities have not stated or suggested that such was the case at any stage of the procedure laid down in Article 93(2) of the Treaty. On the contrary, the continued operation of the companies concerned has resulted in a considerable increase in the taxes and social security contributions remaining unpaid [14]. Moreover, Migsa's and Gursa's debts have been declared irrecoverable (Gursa's debt with the national Treasury being an exception). In the cases of Indosa and Cunosa, it was the workers who started the bankruptcy proceedings.

If the arguments put forward by the Spanish authorities were accepted, any company without assets free of charges — that is, any company on which forced recovery proceedings would have no purchase — could continue to operate on the market without fulfilling its tax and social security obligations as long as other possible creditors did not instigate bankruptcy proceedings against it.

Consequently, the Commission concludes that the persistent and systematic non-payment of taxes and social security contributions since 1989 and up to the declaration of bankruptcy or the breaking-off of activities constitutes a transfer of public resources to Indosa, Cunosa, Migsa and Gursa which gives them a competitive advantage, since — unlike their competitors — they are not obliged to defray these costs as would ordinarily be the case. This situation therefore constitutes aid as described in Article 92(1) of the Treaty.

The fact that neither the Treasury nor the Social Security have stated formally that they no longer intend to collect the sums

[14] As indicated in the report on the bankruptcy of Indosa submitted by the bankruptcy commissioner on 4 October 1995, some of the unpaid taxes date back to 1982.

owed (which means that the latter still legally constitute a debt and have not been cancelled) does not detract from the fact that the companies have been able to operate without fulfilling their tax and social security obligations [15]. Over the same period, their competitors have not benefited from such financial advantages. The sums in question supplied by the Spanish authorities are as follows:

(ESP)

	Social Security	National Treasury	Treasury of Autonomous-Community
Indosa	4 602 668 983	210 794 754	1 898 219 433
Cunosa	1 772 814 657	790 999 650	—
Migsa	586 934 823	To be determined	—
Gursa	2 767 769 021	525 401 696	—

The Commission has not been informed of the total amount of national taxes not paid by Migsa. It is the responsibility of the Spanish authorities to supply this information.

Persistent non-payment of taxes and social security contributions after Indosa's declaration of bankruptcy

Initiation of the procedure under Article 93(2) of the Treaty has enabled the Commission to confirm that the allegations put forward by complainants regarding Indosa's persistent failure to fulfil its tax and social security obligations between the declaration of bankruptcy on 19 July 1994 and May 1997 were correct and justified. Moreover, this procedure has also enabled the Commission to establish the existence of aid within the meaning of Article 92(1) of the Treaty.

Bankruptcy followed by 'continued activity' is not provided for as such under current Spanish law. Given the nature of the bankruptcy laws and the size of the public claims, continuing to operate without meeting tax and social security obligations further damages the interests of the Treasury and the Social Security, in that persistent non-payment automatically reduces the bankrupt's assets: the debts resulting from the administration of the assets, such as taxes and social security contributions, have to be paid first, taking priority over debts towards other creditors.

The Commission concludes from the documents submitted by the Spanish Government that Indosa was able to continue operating after the declaration of bankruptcy because the meeting of its creditors, held on 30 January 1995, agreed to this. The record of the meeting contains no references to opposition by the Social Security or the national or regional Treasuries. Given the size of their claims, these institutions, together with the other public creditors, had enough votes to block consent to Indosa's continued operation.

The Spanish authorities have not provided any explanation as to why the public creditors did not exercise their right to veto such consent.

The above implies that the meeting of Indosa's creditors accepted its continued operation after the declaration of bankruptcy as a result of the behaviour of the public creditors at the meting of 30 January 1995.

The Commission has investigated whether the public creditors behaved in this way with a view to maximising their chances of recovering their claims, which totalled ESP 6 749 698 323. At no stage of the procedure laid down by Article 93(2) of the Treaty have the Spanish authorities stated or suggested that this was the case. However, the public creditors, particularly the Social Security and the Basque Regional Treasury, knew that if Indosa, which was bankrupt, continued to operate, it was likely to run up further debts, given its difficult situation and its tax record (it had avoided paying the Social Security or the Treasury for years). They should therefore at least have made continued activity conditional on Indosa's meeting its current tax and social security obligations, in order to avoid running up further debt. Given the nature of bankruptcy laws, such an increase would automatically reduce the bankrupt's assets, as debts arising from the administration of the bankruptcy, such as those generated by the non-payment of taxes and social contributions, take precedence over other claims. A private creditor would not have behaved in a way likely to reduce the chances of recovering his claim.

The behaviour of the public creditors has been influenced by different aspects of the State's commitment to guarantee as far as possible the recovery of their claims against the bankrupt company. Moreover, the fact that large amounts of taxes and social security contributions remained effectively unpaid between July 1994 and April 1997 shows that Indosa's continued operation has supported economic activities which would have been unsustainable in any other way under normal market conditions.

The Commission takes the view that the non-payment of taxes and social security contributions constitutes a transfer of public funds to Indosa, giving it a competitive edge; unlike its competitors, it does not have to cover this particular cost in the normal way. This analysis is not affected by the fact that

(15) Advocate-General Jacobs stated in his opinion of 24 September 1998 in Case C-256/97, *D. M. Transport*, that it was clear that, in certain circumstances, continued generous tolerance of the delayed payment of social security contributions could confer a considerable commercial advantage on the beneficiary company, and that it could, in extreme cases, amount to debt forgiveness with regard to those contributions (paragraph 33).

the beneficiary of this transfer is Indosa in its capacity as the assets of the bankruptcy, not Indosa the company.

The fact that neither the Treasury nor the Social Security have formally stated their intention to abandon their claims (which means that they still constitute debt, legally speaking, and have not been written off) does not detract from the fact that the company has been able to operate without meeting its tax and social security obligations [16]. Indosa's rivals did not enjoy the same financial advantage during the same period. Moreover, the debts arising from the non-payment of taxes and social security contributions after the declaration of bankruptcy are covered by the administration of the bankruptcy (debts payable from the bankrupt's assets) and, under Spanish law, may be subject to separate forced collection procedures. The information supplied by the Spanish authorities shows that no separate enforced collection procedure has been initiated, despite the considerable size of the debt arising from the non-payment of taxes and social security contributions.

It may thus be concluded that Indosa's persistent non-payment of social security contributions totalling ESP 1 282 117 590, in addition to the non-payment of an unspecified amount of tax during the period between the declaration of bankruptcy (19 July 1994) and April 1997, after all Indosa's public creditors had accepted that it would continue operating without any financial guarantees, constitutes aid within the meaning of Article 92(1) of the Treaty.

The Commission has not been informed of the total amount of tax owed to the regional Treasury of Vizcaya. It is the Spanish Government's responsibility to supply this information.

The persistent non-payment of taxes and social security contributions:

— by Indosa, Cunosa, Migsa and Gursa until the declaration of bankruptcy or the break in activities,

— by Indosa after the declaration of bankruptcy,

is thus considered to constitute aid within the meaning of Article 92(1) of the Treaty.

This aid was not granted as part of an authorised aid scheme and should therefore have been notified on an individual basis, as stipulated by Article 93(3) of the Treaty. The Spanish authorities' failure to meet this requirement means that the aid was granted illegally. The exceptions provided for by Article 92(2) of the Treaty are not applicable in this case, since the aid was not granted to achieve the objectives set out in Article 92(2). The Spanish Government has not invoked Article 92(3) of the Treaty in connection with the measures deemed by the present Decision to constitute aid.

As regards the derogations provided for by Articles 92(3)(a) and (c) of the Treaty for aid designed to promote or facilitate the development of certain areas, with the exception of San Roque (Cadiz), none of the areas where Indosa, Gursa and Cunosa are based (Derio (Vizcaya), Guriezo and Limpias (Cantabria)) have an abnormally low standard of living or serious under-employment within the meaning of Article 92(3)(a). Moreover, although the plant is in an assisted area, as referred to in Article 92(3)(c), the aid granted to these companies does not have the character of aid designed to promote the development of certain economic areas, as provided for in the above Article, because it was granted as operating aid (that is, aid the granting of which is not conditional on investment or job creation). The aid granted in San Roque (Cadiz) was not part of the regional aid scheme in that area. However, operating aid in the areas provided for by Article 92(3)(a) of the Treaty may also be covered by the derogation set out in that provision where such aid is granted subject to certain restrictive, controlled conditions, described below with reference to companies in difficulty.

As regards the exceptions provided for by Article 92(3)(b), the aid measures analysed are not concerned with, nor do they have the character of 'an important project of common European interest' or a project 'to remedy a serious disturbance' in the Spanish economy. Moreover, the Spanish authorities have not requested any derogation on these grounds.

Article 92(3)(c) also provides for an exception to be made for 'aid to facilitate the development of certain economic activities'. The aid granted to Indosa, Cunosa, Migsa and Gursa falls into the category of aid to companies in difficulty.

The aid granted does not fulfil the conditions for a derogation laid down in Article 92(3)(c) in conjunction with the 'Community guidelines on state aid for rescuing and restructuring firms in difficulty' [17].

The aid does not meet the conditions laid down in the guidelines on rescue aid. Restructuring aid must be linked with a viable restructuring programme which must be submitted in detail to the Commission. In the present case, the Spanish authorities have not provided any evidence that the aid granted to the companies concerned is linked with a programme of restructuring designed to restore their long-term viability. It is worth pointing out that a plan submitted to the Basque authorities in 1996 by the receivers administering Indosa's bankruptcy was not accepted by the authorities because, among other things, it failed to put forward a realistic proposal on Indosa's institutional debt (towards the regional Treasury, the Social Security, and other agencies).

The fact that Indosa now has hopes of a positive cash flow does not negate the fact that it, and the other companies in question, were able to continue operating firstly thanks to the non-recovery of the aid declared incompatible in 1989 and secondly because it was not compelled to meet its tax and

(16) See footnote 15.

(17) OJ C 368, 23.12.1994, p. 12.

social security obligations. Had that not been the case, it would have ceased to operate.

The Commission therefore takes the view that the aid is incompatible with the common market as referred to in Article 92(1) of the Treaty because it does not meet any of the necessary requirements for the application of any of the derogations provided for in Article 92(2) and (3).

When aid is deemed incompatible with the common market, the Commission requires the Member States to call on the beneficiary to pay it back [18]. Since this is the case with the measures in favour of Indosa, Cunosa, Migsa and Gursa, which are the subject of the present Decision, the aid must be recovered.

The aid must be recovered in accordance with the procedures and provisions laid down in Spanish law, and must include the interest which has accrued between the date on which the aid was granted and the date on which it is actually repaid, calculated at a rate equal to the percentage value on that date of the reference rate used to calculate the net grant equivalent of regional aid in Spain [19].

In accordance with the case-law of the Court of Justice, the abovementioned provisions must be applied in such a way as to ensure that it is not in practice impossible to recover the aid as required by Community law. Any difficulties, of a procedural or other nature, which may arise in applying the measure will not affect its legal validity [20],

HAS ADOPTED THIS DECISION:

Article 1

The aid in the form of the persistent non-payment of taxes and social security contributions:

— by Indosa and Cunosa until they were declared bankrupt,

— by Migsa and Gursa until their activities were interrupted, and

— by Indosa after its declaration of bankruptcy and until May 1997,

is illegal, as it was granted by Spain in breach of its obligations under Article 93(3) of the EC Treaty.

The aid is considered to be incompatible with the common market within the meaning of Article 92(1) of the Treaty, as it does not meet any of the necessary conditions for the application on any of the derogations provided for by Article 92(2) and (3).

Article 2

1. Spain shall take the necessary measures to recover from the beneficiaries the aid referred to in Article 1 which was granted to them illegally.

2. The aid shall be recovered in accordance with the procedures and provisions laid down in Spanish law. The sums to be recovered shall include the interest which has accrued between the granting of the aid and the date on which it is actually repaid. The interest shall be calculated on the basis of the reference rate used to calculate the net grant equivalent of regional aid in Spain.

Article 3

Spain shall inform the Commission within a period of two months from the date of notification of the present Decision of the measures to be taken to comply therewith.

Article 4

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 14 October 1998.

For the Commission

Karel VAN MIERT

Member of the Commission

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(18) Commission communication of 24 November 1983 (OJ C 318, 24.11.1983, p. 3). See also the Court of Justice's judgments of 12 July 1973 in Case 70/72 Commission v. Germany [1973] ECR 813, and 24 February 1987 in Case 310/85 Deufl v. Commission [1987] ECR 901.

(19) Letter from the Commission to the Member States SG (91) D/4577, 4 March 1991. See also the Court of Justice's decision of 21 March 1990 in Case 142/87 Belgium v. Commission [1990] ECR I-959.

(20) See the judgment cited in footnote 19, paragraphs 58 to 63.