

Commission authorizes restructuring aid to Alstom under conditions

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1. Introduction

On 7 July 2004 the Commission adopted a decision to authorize State aid to Alstom under a series of important and innovative conditions. This decision closes the investigation procedure initiated in September 2003. The assessment phase of the case has attracted intense interest from the media and from interested parties: indeed the Commission has received submissions from numerous actors — competitors, clients, suppliers, trade unions, local authorities — who intervened in the procedure. The attention the case received can be attributed to the importance of the company — Alstom is a leading engineering group which employed more than 100 000 persons in 2003 — and to the high amount of aid France intended to grant.

2. Alstom's activities and competitors

Alstom is an engineering group which had a turnover of € 21.3 billions for the year 2002-2003. It is active in three different markets:

- It designs, builds and services infrastructures and systems for the power generation market (hereafter 'Power'). Besides Alstom, three other players offer a broad range of products and have a significant market share at world level: GE, Siemens and Mitsubishi HI.
- It designs, builds and services products and systems for the rail transport market (hereafter 'Transport'). Alstom is a leader player in that market together with Bombardier and Siemens.
- It builds complex ships, mainly LNG tankers and cruise ships (hereafter 'Marine'). The latter market is dominated by European companies, namely Alstom, Fincantieri, Aker Kvaerner and Meyer. Marine represents a smaller share of Alstom turnover than Power and Transport.

Until 2003, Alstom was also active in building infrastructures for transmission and distribution of power (hereafter 'T&D').

One characteristic of these markets is the importance of being able to obtain guarantees, more

precisely bonding. Bonding is provided through a financial institution by the supplier (e.g. Alstom) to the buyer of goods that can be delivered several years after being ordered... The purpose of bonding is to guarantee the buyer against the risk that the supplier does not deliver the ordered good, or delivers a good that does not fulfil all the requirements. The cost and availability of bonding to the supplier depend on its financial strength and is inversely related to the risk the financial institutions attribute to its business.

3. On the way to bankruptcy

During the three fiscal years from 2001-2002 to 2003-2004, Alstom booked cumulated losses of nearly € 3.5 billion which led the company to the verge of bankruptcy. Alstom's equity was close to zero at the end of this period, from more than € 2 billion at the start. The company was consecutively facing increasing difficulties to satisfy its bonding needs on the market, which in turn limited the possibility to conclude new contracts. Therefore, in the summer of 2003, Alstom called upon the State for help in order to avoid imminent bankruptcy.

It seems that this situation was mainly the consequence of insufficient risk management and strategic errors. Firstly, in 2000 Alstom bought the gas turbine business of ABB and all contractual liabilities linked to it. It rapidly turned out that the delivered turbines did not match the performances promised to clients. In total, financial compensations to clients and technical improvements on the delivered turbines represented an unexpected cost of € 4 billion for Alstom. Secondly, the company provided guarantee on loans granted to clients upon order of cruise ships. When some clients filed for insolvency, Alstom was liable for nearly € 1 billion. Thirdly, Alstom began the building of a series of trains before the receipt of all the specifications. As the latter turned out to be different than expected, Alstom had to perform adaptations representing € 140 million additional costs.

Besides these company-specific problems, the economic environment was also less favourable from 2001 onwards. After years of strong growth, demand for power plants and cruise ships began to decline. Moreover, after 11 September 2001, risk aversion increased and financial institutions were more reluctant to grant bonding, especially to less solid companies.

4. State aid and private financial contribution

The decision adopted by the Commission recognised that Alstom fulfilled the conditions to be eligible for rescue and restructuring aid. In particular, the Commission found that a restructured Alstom can operate as a healthy market player in the world industry. For this reason, the Commission authorised the involvement of the French State alongside private operators in the turnaround of the company.

The decision authorises the following State aid:

- € 100 million of short term and 300 million of long term senior loans
- Participation up to € 1 billion in two capital increases
- A second rank guarantee of € 1.25 billion covering an 8 billion bonding facility. During the past twelve months, the State also provided a guarantee on another bonding facility. This one year guarantee was considered to represent € 411 million of aid. In total, guarantees on bonding therefore represent half of the more than € 3 billions of aid authorised.
- In order to replace bonding unavailable when Alstom was on the verge of bankruptcy in 2003, the government provided written guarantees to Gaz de France and SNCF for the good execution of the orders they placed to Alstom during that period.

Besides this public intervention, financial institutions and other private investors intervene massively to provide Alstom with new financial means. The conditional decision is based on their participation in the following form:

- € 300 million of senior loans
- € 2.1 billion of subordinated loans (part of which can be converted in capital)
- Participation between € 1.13 and € 1.3 billion in three capital increases
- Bonding facility of € 8 billion (2 year revolving period). As first losses on this facility are guaranteed by a cash collateral (€ 700 million) and in second rank by the State, the exposure of the banks amounts to € 6.05 billion.

Finally, Alstom generated itself financial means. The restructuring plan started in March 2003 led to the sale of two major departments, small gas turbines to Siemens and T&D to Areva, which brought in nearly € 2 billion. The revenue of additional divestitures required by the Commission will increase this amount. Additionally, Alstom will use € 700 million raised by means of the last capital increase to create a first loss guarantee covering the € 8 billion bonding facility.

5. Conditions linked to the authorisation of the restructuring aid

The *Community guidelines on State aid for rescuing and restructuring firms in difficulty* were the legal base used by the Commission for the assessment of the aid. They establish a set of conditions which have to be fulfilled in order to consider the aid as compatible with the common market on the basis of Article 87 (3) (c) of the Treaty:

5.1. Restoration of viability

Combined with the financial injections exposed in section 4, the wide reaching operational restructuring plan presented by France following the decision to initiate the investigation procedure and consisting of reorganisation, plant closures and personnel reductions, was deemed sufficient to tackle the majority of the problems and overcapacity identified by the Commission. However, two weaknesses remained and endangered long term prospects. On the one hand, restructuring in the Marine sector was insufficient in comparison with the level of orders expected for the next years. This sector had to break even from a lower level of demand. On the other hand, the net income of Alstom foreseen at the end of the restructuring period was very low and could not be considered as a sufficient buffer against unexpected problems.

Accordingly, in addition to the full execution of the restructuring plan, the authorisation of the aid is conditional on deeper restructuring in the Marine sector and, in order to improve long term viability, on the conclusion of one or several industrial partnerships covering a significant part of Alstom's activities. The partners have to be financially sound and to contribute to the partnership from a financial and an industrial perspective.

5.2. Avoidance of undue distortions of competition

Without the aid granted by France, Alstom would have gone bankrupt. Part of its activities would

have been taken over, but others would have simply disappeared. This could have been the case for the Gas Turbine and Marine sectors, where the bulk of Alstom's problems comes from. The State intervention, by keeping Alstom alive, creates an important distortion in these markets where most of the competitors, have large plants and employ tens of thousands of workers within the European Union. Accordingly, the Commission had to put conditions in order to minimize distortions created by the aid and to compensate competitors.

In this context, section 2 here above illustrates one of the main challenge the Commission faced, namely the oligopolistic structure of Alstom's markets. As compensatory measures, 'traditional' divestments could have reinforced this structure and created or strengthened dominant positions. In order to solve one distortion of competition this may have created another one. Another analytical challenge was the assertion of Alstom that within the Power sector, the most important sector of the company, the sale of certain departments would put the whole chain of value at risk and make the company not viable. The decision adopted by the Commission solves these constraints by a careful choice of the activities to sell and by including a series of rarely used — but foreseen in the guidelines — measures to limit Alstom presence on certain markets:

- In addition to the sales of the small gas turbines and the T&D sectors, which represented 20% of Alstom's turnover, additional divestitures representing another 10% was required.
- A joint venture has to be created, covering the hydro power activities of Alstom.
- The conclusion of industrial partnerships, in addition to improve viability, will force Alstom to share its control on important activities. If the partner is controlled by the State, previous approval of the Commission is required in order to avoid hidden subsidies.

Three other conditions were specifically targeted at the Transport sector:

- France committed itself to several structural measures which should contribute to the opening of the French rolling stock market, which now remains to a large extent national.
- Margin in the different sub-sectors will be yearly controlled during 4 years to verify the absence of predatory pricing
- Total amount devoted to acquisitions of companies during the next four years is capped to € 200 million.

Eventually France committed itself to sell its participation in Alstom's capital before 4 years. As State aid takes to a large extent the form of capital injection, the exit of the public shareholder will contribute to restore initial competitive situation in this market.

5.3. *Aid limited to the minimum*

The limitation of aid to the minimum represented a challenge for the Commission as financial needs of Alstom were huge. The company needed to reconstitute its equity after its total depletion due to several billion losses. In addition restructuring costs should amount to nearly 1 billion. Finally, it was impossible for Alstom to recover without the availability of bonding. In this context, the Commission recalled several times that the contribution from financial institutions, private investors and the company itself has to be increased to the maximum possible. The Commission estimates this is the case in the package included in the conditional decision described in section 4. It is worth noting that the maximum exposure of the State is considerably lower in this package than the package initially foreseen by the French authorities. Moreover, the early amortisation of the State guarantee on the bonding facility and its exit as shareholder will limit the length of the aid

The control on margins and on the size of acquisitions in the Transport sector mentioned previously will avoid that State aid, which became necessary because of exceptional losses in the Marine and gas turbine sectors, is diverted to Transport in order to finance predatory behaviours. Indeed, in a conglomerate structure such as Alstom's, it was impossible to direct State aid to specific sectors. The aid was granted at Corporate level. Pricing policy and external growth, since they constitute external behaviours, can be controlled by the Commission and will be used as indicators to check that the advantage of the aid is not used where it was not needed.

6. Conclusion

The Alstom case illustrates the paramount importance of State aid control performed by the Commission. On the one hand, France legitimately wanted to avoid bankruptcy of such a high profile engineering group. On the other hand, its intervention had to be controlled in order to avoid that the whole burden of the adjustment falls on Alstom's competitors and their tens of thousands of European workers.