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Subject: National accounts treatment of the capital injections into AREVA

Ref: Your letter N° 01/DG75-G401 dated 19 January 2018
Ad-hoc visit discussions of 9-10 January 2018
Your letter N° 21/DG75-G401 dated 13 October 2017
Our letter (2017)4897281 dated 6 October 2017
Your letter N° 19/DG75-G401 dated 22 September 2017
EDP Dialogue visit discussions of 22-23 May 2017

Dear Mr Mahieu,

Thank you for your letter dated 22 September 2017, complemented by your letters dated 13 October 2017 and 19 January 2018, concerning the national accounts treatment of the capital injections into AREVA. After a careful examination of the issue, Eurostat is in a position to provide you its final opinion on the basis of the information provided.

I. THE ACCOUNTING ISSUE TO BE CLARIFIED

The accounting issue to clarify is the appropriate recording of two capital injections by the French government, carried out in 2017, for a total of 4.5 billion euro, in the context of the restructuring of AREVA.

Description of the AREVA restructuring

AREVA is a French multinational group specialized in nuclear power and renewable energy, mostly engaged (1) in construction of nuclear reactors, and (2) in the nuclear fuel cycle (uranium enrichment, radioactive waste retreatment). The current scope of the AREVA group was mainly achieved from the merger of *Framatome* and *COGEMA* in 2001.

As of mid-2016, AREVA was mostly owned by the French State through various entities: (1) *Commissariat à l'énergie atomique et aux énergies alternatives* (CEA - 54.4% as of mid-2016),

(2) *Agence des participations de l'État* (APE - 28.8%), and (3) *Banque publique d'investissement* (3.3%). Moreover, *Électricité de France*, the main electricity producer in France (itself 83% held by French State) owned 2.2% and *Kuwait Investment Authority* owned 4.8%.

Subsequent to considerable losses cumulated over the years (approximately 8 billion euro over 2013 - 2016), a restructuring of the nuclear sector was decided. Aside from a series of disposal of some businesses of a secondary nature, this restructuring involved splitting AREVA's activities into two newly created companies: *AREVA NP* and *New AREVA Holding* (hereinafter called "*NewCo*"), which took over each of the two above mentioned separate lines of business of AREVA.

AREVA SA, the head entity, retains some residual interest and most crucially the risks associated to the completion of the Olkiluoto (Finland) EPR nuclear reactor, aside from the initial ownership in these subsidiaries.

As a second step of the process, *AREVA NP* main activities (construction of reactors) are largely sold off to EDF, for an amount of 2.5 billion euro, while *NewCo* (fuel cycle) is partially sold off to the State (acquiring 55.6% stake for 2.5 billion euro) as well as to two private Japanese investors (Mitsubishi Heavy Industries and Japan Nuclear Fuel Limited, for 0.5 billion euro in total). The *NewCo* transaction takes the form of direct capital injections by the new partners in *NewCo*. In contrast, the sale to EDF takes the form of the sale of shares by AREVA of a specially created subsidiary of *AREVA NP* (herewith "*New NP*"). Aside from that, *AREVA SA* receives a capital injection of 2 billion euro by the French State.

In total, 4.5 billion euro in AREVA recapitalisation has been subscribed directly by the French State in July 2017, in the form of a participation in the capital increases of *AREVA SA* (2 billion euro) and of *NewCo* (2.5 billion euro). The 4.5 billion euro were settled mostly through the conversion of shareholders advances of 3.3 billion euro (2 billion euro to *AREVA SA* and 1.3 billion euro to *NewCo*) made by the State in February 2017 to ensure the liquidity of AREVA group at that time, and through additional payments of 1.2 billion euro.

It is noted that the participation of the Japanese partners to the capital increase of *NewCo* will take place only at a second stage (in principle during the course of 2018), and that in the meantime it is withheld in an escrow account, conditional on the realisation of certain number of steps. Similarly, the sale of a majority stake of *New NP* to EDF is conditional on a number of steps to be fulfilled. Moreover, EDF found partners to invest in *New NP*: Mitsubishi Heavy Industries and a French company, Assystem.

Description of the statistical issue and analysis of INSEE

The question that INSEE raises is whether Eurostat concurs with INSEE's analysis that, whereas the capital injection by the State in *AREVA SA* is to be treated as capital transfer expenditure (D.9), impacting the government deficit (B.9), the capital injection by the State in *NewCo* should be considered as a financial transaction (F.5) without impact on the government deficit.

The rationale of INSEE position is that the *AREVA SA* injection is covering past losses and also bears important risks with respect to the Olkiluoto project, which is a clear case for recording an

impact on the government deficit. In contrast, INSEE argues that the injection in *NewCo* should be considered as financial given that (1) *NewCo* is a profitable business, being specialised in nuclear fuel cycle, (2) *NewCo* does not bear identifiable risks inherited from past activities of AREVA, and (3) private investors jointly participate to the capital increase.

II. METHODOLOGICAL ANALYSIS AND CLARIFICATION BY EUROSTAT

II.1 Applicable accounting rules

- ESA 2010 paragraph 20.196 and 20.198 on capital injections;
- ESA 2010 paragraph 20.121 on loans unlikely to be repaid;
- ESA 2010 paragraph 20.164 on substance over form;
- MGDD Chapter III.2 Capital injections into public corporations;
- MGDD section I.6.3 on public head offices, public holding companies and their subsidiaries.

II.2 Analysis by Eurostat

II.2.1 Injection in AREVA SA

Eurostat concurs with INSEE that the capital injection of the French State in *AREVA SA* (2 billion euro) has the nature of a capital transfer, with an impact on the deficit, given that such an injection occurs in the context of considerable past losses of the AREVA group (8 billion euro) over the period 2013-2016. In addition, Eurostat notes the significant risks assumed by this entity concerning the completion of the Olkiluoto project. Eurostat also notes that *AREVA SA* (as well as *NewCo*) has negative net assets (of 1.5 billion euro as of end 2016).

ESA 20.198(a) indicates that "*A payment to cover accumulated, exceptional or future losses, or provided for public policy purposes, is recorded as a capital transfer. Exceptional losses are large losses recorded in one accounting period in the business accounts of a corporation, which usually arise from downward revaluations of balance sheet assets, in such a way that the corporation is under threat of financial distress (negative own funds, breach of solvency, etc.)*".

Eurostat draws the attention on the fact that the capital transfer may perhaps have to be recorded in 2017Q1 (or possibly earlier: see below) – at the time of the cash advance, rather than in 2017Q3 at the time of equity conversion – given the fact that the shareholder advance had no prospect to being reimbursed whatsoever. Indeed, AREVA itself recognizes (page 14 of its reference document for 2016) that "*in the event of a significant delay in.... capital increases, or in the event that said capital increases are not carried out, the group could be unable to reimburse the shareholder current account advances...*". The non-reimbursement of these advances was thus foreseen as part and parcel of the restructuring plan. The shareholder advance was necessarily to be converted into equity or abandoned. ESA 20.121 states in this respect that "*Loans granted by government not likely to be repaid are recorded in the ESA as capital transfers (...)*".

II.2.2 Injection in *NewCo*

As explained in the EDP Dialogue visit of May 2017, in the letter dated 13 October 2017, and again during the Ad-hoc visit of January 2018, Eurostat does not concur with the INSEE analysis with respect to the injection in *NewCo*, for three main reasons: (1) the two operations should be conceived as one unique transaction, in general, which is particularly recommended in the light of the way the injection of *NewCo* was actually carried out; (2) DG-COMP State aid ruling implies the recording of a capital transfer; and (3) Eurostat considers, at this stage, that the criteria of joint participation of the private sector is not fulfilled according to the MGDD rules.

(1) The two operations should be seen as one unique transaction

Main reason for recognizing one unique transaction

The principal reason of the objection of Eurostat to the INSEE position is that Eurostat considers that the two injections, while legally distinct, cannot be economically separated. Substance over form (ESA 20.164) prescribes that a unique transaction is recorded.

In this context, Eurostat notes that the European Commission (DG-COMP) has considered that the two capital injections were compatible State Aid and, in its motivation, explicitly considered that the two injections were a unique operation.

The CE Decision 2017/1021, 5.1.1. *The French State's subscription to the capital injections into AREVA SA and New Areva:*

- *recital 185: Although these two interventions are seemingly separate, the Commission considers that the State's subscription to the capital injections into AREVA SA and New AREVA respectively must be regarded as a single aid measure made available to Areva. It is apparent from the analysis of the difficulties and indebtedness of the AREVA Group that as a whole it needs capital. The fact that this overall need for recapitalisation is subsequently broken down between AREVA SA and New AREVA is nothing more than an implementing arrangement for recapitalising Areva;*
- *recital 187: [...] The two third-party investors MHI and JNFL will not subscribe to the capital of the AREVA Group in the same way as the French State, since their investment will concern only one of the two entities of the restructured AREVA Group (New Areva), and for a minority stake of [...]%;*
- *recital 190: In the light of the above, the Commission concludes that the French State's subscription to the capital injections in AREVA SA and New AREVA constitutes State Aid within the meaning of Article 107(1) TFEU , in favour of the AREVA Group, amounting to EUR 4.5 billion.*

In addition, AREVA itself presents the rescue as one operation already in its Annual report 2016.

Statistical implications

INSEE also recognizes that AREVA was subject of one unique rescue operation, but considers that there is no specific statistical implication flowing from this. In contrast, Eurostat believes that allowing recording differently various injections in different entities split from a 'mother' entity under recapitalization could generally open the way to circumventing the capital injection test rules. Eurostat considers that the partitioning of an entity with very significant accumulated losses can always be carried out through carving out a 'good entity' and a 'bad one', and having a large part (if not all) of the rescue money transiting via the 'good entity'. For this reason, the capital injection test should always be carried out disregarding any partitioning.

Additional reasons to consider that the operation is unique and implies capital injection testing for the full amount

Eurostat first observes that the State provided to AREVA group 3.3 billion of cash in February 2017, on an emergency basis, to meet liquidity needs. These advances were made to both AREVA SA and NewCo, which would suggest that in fact both entities were under financial stress. This observation thus supports the view that the two injections should be considered as one unique transaction and also that both injections should be treated as expenditure.

Second, during its investigations, Eurostat found a number of characteristics concerning the design of the injection in *NewCo* that supports the view that the latter cannot be separated from the injection in AREVA SA (or would suggest a need to route the capital injection in *NewCo* through AREVA SA):

- a) AREVA debts (mostly bonds) are split and allocated to the various entities, including to *NewCo* (for the bonds),
- b) AREVA SA retains a 40% ownership in *NewCo* despite having negative assets (before the 2.5 billion euro injection by the State and 0.5 billion euro injection by MHI and JNFL);
- c) AREVA group cash assets will be split in the future.

The most interesting issue concerns the transfer of the bonds of AREVA group to *NewCo*. Page 25 of the condensed consolidated financial statements of *NewCo* of 30 June 2017, read: "*As security, AREVA SA has committed to guaranteeing the redemption of all bond issues contributed to New AREVA Holding and to guaranteeing the derivatives of New AREVA Holding with banking counterparties, for New AREVA Holding's benefit. At June 30, 2017, the carrying amount of New AREVA Holding's bond debt was 4.927 billion euros. Those guarantees will end once the capital increase of New AREVA Holding has been carried out in the amount of at least 3 billion euros or, for the guarantee concerning the bond issues, once they have been redeemed.*"

During the ad-hoc visit, INSEE flagged that the transfer of AREVA bonds to *NewCo* had had as counterpart fixed assets for a similar amount and that the bondholders had jointly given their authorization for this transfer. However, *NewCo* had negative assets of 1.0 billion euro end-2016, such that it is unclear to Eurostat to what extent the assets transferred were indeed for a similar amount. In fact, the bondholders gave authorisation for such transfer without guarantee, only after the cash injection was carried out, implying that the fixed assets transferred were not enough to cover for the exposure of the bondholders. Thus, the allocation of the bonds to *NewCo* cannot be

separated from, and would need to coincide with, the injection of the cash. The fact that AREVA SA is relieved from its guarantee upon capital injections to *NewCo*, means that the capital injection to *NewCo* in fact benefits AREVA SA, which then pays a sort of a fee to *NewCo* to be relieved from the guarantee it gave.

Furthermore, in the absence of justification, Eurostat considers that the fact that AREVA SA retains 40% of ownership after the injections in *NewCo* also points to the injection being in fact partly made by the State to AREVA SA, which then further injects to *NewCo*. Net assets of *NewCo* are negative, so that AREVA ownership of *NewCo* should have been wiped out.

Finally, the allocation of AREVA SA cash in 2017-2018 in between the various elements of the group is also difficult to understand, except under the assumption that one unique rescue operation is undertaken (with the arbitrary allocation of assets and liabilities this seems to entail).

(2) DG-COMP recognizes State aid for 4.5 billion

The MGDD indicates that when a DG-COMP decision considers that State Aid is provided, a capital transfer expenditure is to be recorded (see Box 1 page 162 of chapter III.2 of the MGDD 2016, which reads: "*The flows deemed to be State aids have to be recorded as capital transfers*"). This applies to the case of AREVA for the full 4.5 billion euro, given the DG-COMP statement that this one operation "*constitutes State Aid within the meaning of Article 107(1) TFEU, in favour of the AREVA Group*".

(3) The "similar conditions" of the private participation criteria are not met

Eurostat is also not convinced that the joint participation in *NewCo* of the two Japanese investors meets the "similar conditions" criteria foreseen in ESA 20.198:

- First, the private participation is significantly lower than the French State participation (with a one to five ratio);
- Second, the private participation is not simultaneous, occurring one year later, and is still conditional on a certain number of steps.

It is to be underlined that, according to the MGDD (III.2.2.3, paragraph 22), the capital injection could be treated as a financial transaction only when private investors would take a significant share in equity "*at the same time*" as the capital injection by government, a condition which is manifestly not fulfilled.

In addition, the private participation is carried out by industrial partners of AREVA, who may be seeking industrial benefits aside from the sole financial benefits they expect, if any.

In this context, it should be noted that the DG-COMP decision judges (in its recital 187) that the two private investors "*will not subscribe ... in the same way as the French State*".

Taking into account the above, Eurostat considers that it cannot be concluded at this stage that ESA 20.198(b) would be applicable in these circumstances (assuming that the two injections could be seen as separate operations). On the contrary, ESA 20.198(a) seems to be fully

applicable to the case of AREVA.

As an aside, by indicating that a joint injection with the private sector under similar condition is "likely" to be evidence of acquisition of equity, ESA 20.198(a) clearly allows cases where a capital transfer is nonetheless to be recorded even when those conditions are met (e.g. case of State Aid).

II.2.3 Injection by EDF

Eurostat further notes that the AREVA group managed to raise 2.5 billion euro from EDF. To the extent that EDF is a public corporation, one may wonder whether the EDF injection should not be routed through government accounts and subject to the capital injection test.

Eurostat notes that, at the same time, EDF intends to carry out a capital raising exercise covering 4 billion euro, with 3 billion euro to be subscribed by the French State. One reason for this capital raising is the cash needs arising from the 2.5 billion spent for the acquisition of *NewNP*.

In normal circumstances, given the fact that EDF is a profitable company, the capital raising subscribed by the French State would be considered as a financial transaction. However, it could be discussed to what extent the present arrangement could be seen as designed in order to avoid showing a higher recapitalisation directly by government in AREVA group.

In case EDF were 100% public, the amount injected by EDF in AREVA would have been most likely rerouted through government accounts. However, having in mind that the State owns only 83% of the equity of EDF, such that private shareholders participate up to 17% in the equity, such a rerouting might not be completely justified.

Nonetheless given the considerable congruence of interest between EDF, AREVA and the State (its main shareholder, its regulator as well as the main player in public infrastructure policy), this issue should not be completely overlooked by INSEE.

Similarly to the *NewCo* transaction, the fact that private third parties participate (not simultaneously) to the *NewNP* capital structure cannot be considered as the main element for the statistical classification, given AREVA past losses.

II.2.4 Time of recording of the injection

It was already noted that the time of recording of the injection could be discussed, given that the formal equity injection in July 2017 largely consisted in converting two shareholder advances made in February 2017, which cannot be repaid unless through conversion.

In addition, Eurostat found that, in the reference document 2016, *NewCo* and *NewNP* are presented unconsolidated upon the rationale that IFRS 5 was applicable, which may suggest in fact that the AREVA group considered the transactions to be effective already in 2016. This may justify a recording of the capital transfer in 2016, instead of in 2017.

Eurostat also notes that the rescue of AREVA could not be avoided given the specific importance of AREVA with respect to its main activity.

III. CONCLUSION

Eurostat considers that the two injections of the State in AREVA (AREVA SA and *NewCO*), for a total of 4.5 billion euro, should be considered as general government expenditure. The main reason is that the two operations should be considered as one unique transaction - which main focus is to rescue AREVA, a group in financial distress after large accumulated losses (8 billion euro, most accruing directly or indirectly to the State, as preponderant shareholder).

This approach of a single transaction, which puts substance over form, is also followed by DG-COMP when formulating its assessment of the operation under State aid rules.

The time of recording of the injection is to be closely considered. It may be in 2017Q1 given the specific circumstances of the shareholder advances, rather than in 2017Q3. In addition, a recording in 2016 may also be supported by some of AREVA documentation.

The capital transfer is to be recorded prior to the reclassification of *AREVA SA* inside government.

IV. PROCEDURE

This view of Eurostat is based on the information provided by the French authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, or there may be inaccuracies in the assessment due to the translation risk, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, as amended, and the note on ex ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat therefore publishes all official methodological advice given to Member States on its website.

(e-Signed)

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