Notice from the administrator of the Swissair Group to creditors and the media

Investigation into the responsibility of the governing and executive bodies of SAirGroup – administrator's interim report

Küsnacht-Zurich, 26 June 2002. At the SAirGroup creditors' meeting on 26 June 2002, the administrator, Karl Wüthrich of Wenger Plattner, presented an initial interim report on the status of investigations into the responsibility borne by the company's governing and executive bodies. A summary of the findings is set out below.

Background

On the basis of powers vested in him by the debt restructuring judge, the administrator instructed Ernst & Young in the spring of 2002 to undertake an investigation into the responsibility borne by the governing and executive bodies of the SAirGroup. This investigation was to take place instead of a special audit. It looked into issues related to corporate governance and the acquisitions made by the Swissair Group as it pursued its "Hunter" strategy. The financial statements from 1999 and 2000 and their auditing are also being investigated, as is the period between the last annual general meeting of the SAirGroup and the suspension of flight operations.
Enquiries are difficult and time-consuming because the transactions under examination are extremely complex and, in some cases, hard to trace. Work is also being hindered by the Swissair-specific filing and documentation system, which contains gaps in some areas. A further complicating factor is that the SAirGroup auditors, PricewaterhouseCoopers and KPMG, have so far not felt able to grant the administrator access to their audit records.
The ultimate findings of the investigation cannot be presented until the work of Ernst & Young is complete in autumn 2002. At this juncture, three problem areas should be mentioned which, given the evaluation of records currently underway, may grow in importance as the enquiry progresses.

Consolidation

In group financial statements, the financial position, the results of operations and the cash flows of the parent company and all its subsidiaries must, by means of the consolidation of the individual financial statements, be presented as though the various companies were one and the same. Subsidiaries are defined as all companies which are controlled by another company. In the context of the International Accounting Standards (IAS), control means that the financial and business policy of a company can be determined by the parent company to such an extent that the parent can draw a benefit from the subsidiary's activities. Holdings in foreign airlines were not fully consolidated in the annual and semi-annual accounts published by the SAirGroup. The investigation will look into the issue of whether not fully consolidating these companies complied with IAS regulations in individual cases, and will also ask whether or not the full consolidation of these foreign airlines in 1999 and 2000 would have presented a different picture of the Group's financial and business circumstances.

"Portage"
Under EU law, the Swissair Group was not permitted to hold a majority share in an EU airline, or to exercise *de facto* control over such an airline by any other means. With these conditions in mind, the senior officers of the Swissair Group attempted to create favourable conditions under which to acquire majority shareholdings in or control of foreign airlines. In its acquisition of Air Littoral, the Swissair Group purchased two tranches of shares, amounting to 95.3% of the company, at a total price of FRF 255 million. Before buying the second tranche, the Swissair Group sold a 46.3% holding to trustees, known as "porteurs", for a token sum of FRF 1. The trustees were indemnified against all costs and any third-party claims in connection with this transaction. The shares acquired by the Swissair Group were written off in full in the year they were bought and the buy-back by the Swissair Group of equity held by the porteurs was hedged by call and put options. The chairman of Air Littoral, who held the remaining 4.7% of the company, also held a put option to sell his shares to Sabena. By its own admission, the Swissair Group thus controlled Air Littoral completely from 29 June 1999. In the context of the present investigation, this raises the question of whether or not the holding in Air Littoral should have been consolidated.

Own shares / equity swap
An equity swap involves a company selling its own shares to a counterparty at the market price and an obligation on the part of the seller to buy back those shares at the end of the agreed term, or leave them with the buyer against the payment of any difference in value. During the term, the seller is charged an agreed rate of interest on the current market value of the securities. An equity swap allows the seller company to improve its liquidity over the term of the transaction while also raising the ratio of equity to borrowing. The economic risk (particularly the price risk attached to the shares) remains with the seller for the term of the transaction. If share prices fall, the seller must make regular additional payments equalling the fall in price. Between 1999 and 2001, the SAirGroup undertook extensive equity swap transactions, leading to outflows of funds and additional payments amounting to several hundred million Swiss francs as share prices fell. In 2001 alone, the total liability attached to two specific transactions stood at CHF 485 million. By the time the debt restructuring application was lodged, CHF 403 million had been settled by payments to banks and a further CHF 25 million had been offset by the banks from mortgaged assets. Here, the present investigation is concentrating in particular on the issue of whether or not all transactions involving the company's own shares, including the equity swap transactions, were booked properly and shown accurately in the individual financial statements as well as in the accounts for the Group as a whole.

***

Further information

- Administrator's website: www.sachwalter-swissair.ch
- Filippo Th. Beck, Wenger Plattner, telephone +41 (0)1 914 27 70, fax +41 (0)1 914 27 88