COMMISSION OF THE EUROPEAN COMMUNITIES

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COM(97) 132 final

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Proposal for a

COUNCIL REGULATION (EC)

on aid to certain shipyards under restructuring and amending Council Regulation 3094/95

(presented by the Commission)

PROPOSAL FOR A COUNCIL REGULATION AMENDING REGULATION (EC) N° 3094/95 ON AID TO SHIPBUILDING

EXPLANATORY MEMORANDUM

Introduction

As stated in Council Regulation (EC) No. 1904/96 the relevant rules of the Seventh Council Directive on aid to shipbuilding (90/684/EEC, further called "the Directive") remain applicable pending the entry into force of the OECD Shipbuilding Agreement and until 31 December 1997 at the latest.

Under the Directive operating aid granted to shipyards, including contract-related production aid (whether direct or indirect)is subject to a common maximum aid ceiling. The only operating aid exempted from this ceiling are credit facilities complying with the 1981 OECD Understanding on Export Credits for Ships (Article 4.6) and aid granted as development assistance to developing countries (Article 4.7).

As regards investment aids the Directive requires that these must be linked to a restructuring plan which does not involve any increase in the yard's shipbuilding capacity or which must be directly linked to a corresponding irreversible reduction incapacity of other yards in the Member State concerned. The prime condition for closure aid is that the resulting capacity reduction is of a genuine and irreversible nature.

Apart from these general rules the Directive provided also for a number of time- limited derogations for certain Member States which are now expired. However, in a number of cases the targets of the underlying restructuring programmes could not be achieved in the expected time frame or new developments on the markets require further measures. It is for this reason that a number of Member States have notified the Commission of plans to grant aid in support of necessary further restructurings of a number of shipyards. The aid programmes include various measures that are not compatible with the existing Community rules. They could therefore only be approved by the Commission if the Council were to adopt an amendment of the Regulation which would in essence update previous derogations.

The background and the technical details of the cases concerned are described in annexes 1 (Germany), 2 (Greece) and 3 (Spain) of this document.

Proposal

Accordingly and in the light of the information provided in the annexes 1 to 3 it is proposed that the Council adopts, after consultation of the European Parliament and the Economic and Social Committee, the attached "Council Regulation on aid to certain shipyards under restructuring and amending Council Regulation 3094/95.

Proposal for a Council Regulation

on aid to certain shipyards under restructuring

and amending Council Regulation 3094/95

THE COUNCIL OF THE EUROPEAN UNION

Having regard to the Treaty establishing the European Community, and in particular Articles 92(3)(e) and 113 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas by virtue of Council Regulation (EC) No. 3094/95[1], as last amended by Council Regulation (EC) No. 1904/96[2] the provisions of Council Directive 90/684/EEC[3], amended by Council Directive 92/68/EEC[4] are applicable to aid to shipbuilding until either the OECD "Agreement respecting normal competitive conditions in the commercial shipbuilding and repair industry"[5]enters into force, or at the latest until 31 December 1997,

Whereas the shipbuilding industry is important for the mitigation of structural problems in a number of regions of the Community,

Whereas the direct application of the common maximum ceiling does not allow for the comprehensive restructuring measures necessary in a number of shipyards in these regions and a special transitional arrangement should therefore be introduced,

Whereas it was acknowledged in Council Directive 92/68/EEC that the shipbuilding industry in the territories of the former German Democratic Republic required urgent and comprehensive restructuring in order to become competitive, a target which has not been fully achieved for two shipyards in the envisaged restructuring period due to unforeseeable circumstances beyond control of these shipyards,

Whereas in the case of the two shiyards located in the former German Democratic Republic a further transitional arrangement is needed, in order to enable a completion of their restructurings, which shall allow them to comply subsequently with the aid rules applicable to the Community as a whole,

[1] OJ L332/1 of 30 December 1995
[2] OJ L 251/5 of 3 October 1996
[3] OJ L 380/27 of 31 December 1990
[4] OJ L 219/54 of 4 August 1992
[5] COM (94) 460 final, of 3 November 1994

Whereas the shipbuilding capacity in the territories of the former German Democratic Republic was reduced to 327 000 cgt by 31 December 1995 and whereas the German Government made the commitment to ensure that this capacity limitation is fully respected at least until end of the year 2000, and to extend this limitation until end of 2005 unless the Commission authorizes an earlier termination of the capacity limitations;.

Whereas a further reduction of shipbuilding capacity in Germany will arrive from the closure of the Bremer Vulkan Werft in Bremen-Vegesack for newbuilding before end of 1997,

Whereas, in spite of the efforts made by the Greek Government to privatise all its public yards by March 1993, the Hellenic shipyard was only sold in September 1995, to a co-operative of its workers, the State having kept a majority holding of 51% for defence interests;

Whereas for the financial viability of the restructuring of Hellenic shipyard necessitates the provision of aid which allows the company to write off the debts accumulated before its delayed privatization;

Whereas a further restructuring of the publicly owned yards in Spain is necessary so that each of these yards, being established as individual profit centers at full cost basis, will achieve financial viability by 31 December 1998,

Whereas under this restructuring plan there will be a capacity reduction in these yards from 240,000 cgrt to 210,000 cgrt, complemented by the non-reopening to shipbuilding of the public yard at Astano (135,000 cgrt capacity) and by additional capacity reductions elsewhere in Spain amounting to a further 17,500 cgrt,

Whereas no further aid for restructuring purposes (including loss compensations, loss guarantees and rescue aid) will be made available to the shipyards covered by this Regulation,

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HAS ADOPTED THIS REGULATION

Article 1

1. Notwithstanding the provisions of Council Regulation No. 3094/95, for the yards under restructuring specified in paragraphs (2) , (3) and (4) the Commission may declare additional operating aid compatible for the specific purposes and up to the amounts there specified.

2. In the Territory of the former German Democratic Republic, operating aid for the period from 01 March 1996 until 31 December 1998 in favour of MTW-Schiffswerft and Volkswerft Stralsund may be considered compatible with the common market up to a total amount of 333 mio DM and 395 mio DM respectively. The said amounts comprise the aid to facilitate the further operation of the yards, social aid, contract-related aid under the "Wettbewerbshilfe" scheme and the aid equivalent of guarantees. For these yards the provisions of Chapter II of Directive 90/684/EEC shall not be applicable during the restructuring period with the exception of Article 4 paragraphs 6 and 7, and no other operating aid may be paid for works on contracts or losses in the relevant period. For contracts signed during the restructuring period but carried out after it, the community rules on contract-related aid as valid on the day of contract signature shall apply.

3. Aid in the the form of a waiver-of debts of "Hellenic shipyards", up to the amount of GDR 54.525 billion, corresponding to debts related to civil work of the yard, as existing on 31 December 1991 and accrued by interest rates and penalties until 31 January 1996 may be regarded as compatible with the Treaty. Apart from Article 5, all provisions of <u>directive 90/684/EEC</u> shall apply to this yard.

4. Aid for the restructuring of the publicly-owned yards in Spain may be considered compatible with the common market up to an amount of 135.028 billion pesetas in the following forms:

   - Interest payments of up to 62.028 billion pesetas in 1988-1994 on loans taken on to cover unpaid previously approved aid
   - Tax credits in the period 1995-1999 of up to 58 billion pesetas
   - Capital injection in 1997 of up to 15 billion pesetas

   All other provisions of directive 90/684/EEC shall apply to these yards.

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Article 2

For the restructuring programmes benefitting from aid as provided for in Article 1, the notification shall be complemented by a programme for the monitoring of the actual use of the investment and operating aid, compliance with the restructuring plan and enforcement of capacity limitations which is acceptable to the Commission.

Article 3

This Regulation shall enter into force on the day following that of its publication in the Official Journal of the European Communities.

It shall apply until 31 December 1998.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

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Derogation for Germany to grant aid towards the completion of the restructuring of two east German shipyards

I. Background

1. On 20 July 1992 the Council adopted Directive 92/68/EEC amending Directive 90/684/EEC (Seventh Directive on aid to shipbuilding) by the addition of Article 10(a), which provided for a derogation for the shipyards on the territory of the former German Democratic Republic. The new Article 10(a) allowed the shipyards in the new Länder to be exempted from the provisions applying to Community shipyards so as to allow them to carry out an urgent and comprehensive restructuring to become competitive. In parallel the German Government had to make sure that a genuine and irreversible reduction of 40% of shipbuilding capacity is carried out by 31 December 1995. Consequently as from 1996 the shipbuilding capacity in the said territory is limited to 327.000 cgt.

2. At the time, there were still seven shipyards active in the said region, of which one, Neptun Werft in Rostock) had been already closed for newbuildings and operates now as a repair and conversion yard with an annual capacity limitation of 300 000 h/a. Another yard, Roßlauer Schiffswerft was closed in the meantime. Consequently, five shipyards remain active in the newbuilding of seagoing vessels in the region. In order to comply with the requirement set out in Article 10(a) of a 40% capacity reduction, the German Government allocated a specific capacity limitation to each of the yards which entered into force on 31 December 1995. The capacity limits of the various yards are as follows:

Table 1: Shipbuilding capacity in Mecklenburg-Vorpommern

Elbewerft Boizenburg	22.000 cgt
Kvaerner Warnow Werft	85.000 cgt
MTW-Schiffswerft	100.000 cgt
Peene-Werft	35.000 cgt
Volkswerft Stralsund	85.000 cgt
Total Mecklenburg-Vorpommern (ex GDR)	327.000 cgt

3. The restructurings of Elbewerft Boizenburg, Kvaerner Warnow Werft and Peene-Werft were completed as envisaged in 1995. These shipyards operate now under the common Community rules. The two others, MTW-Schiffswerft (MTW) and Volkswerft Stralsund (VWS) had been acquired by Bremer Vulkan Verbund (BVV). Their restructurings started with some delay: In the case of MTW, it was temporarily planned to move the yard to a new location. This was given up in spring 1994 and the actual restructuring began only in autumn 1994. VWS was privatised only in 1993, therefore the first restructuring measures started only at the end of that year. The two yards were therefore right in the middle of very major construction works when BVV entered into severe financial difficulties in autumn 1995, which progressed to a failed debt composition procedure in February 1996, and a full bankruptcy in May 1996.

4. Following their privatisation both yards received for their restructurings state aid which was authorized by the Commission in tranches. A total of 597.2 mio DM in operating aid was authorized for MTW under aid N 692/B/91 of 20 December 1992 and aid N 692/I/91 of 11

May 1994. A total of 288.8 mio.DM of the planned 382.2 mio DM in investment aid and 18.0 mio. DM in closure aid were authorized on 20 December 1992 (N 692/B/91) and 20 September 1995 (N 572/95). In the case of VWS, an amount of 680.5 mio DM in operating aid was authorized on 21 December 1993 under aid N 692/F/91. A total of 309.6 mio. DM of the planned 398.7 investment aid and 8.1 of the 8.5 mio. DM closure aid were authorized on 21 December 1993 (N 692/F/91), 21 June 1995 (N 84/95) and 14 November 1995 (N 801/95).

According to the provisions of Article 10(a) of the Directive and the Commission's decisions to authorize the aid, the aid payments had to be strictly limited to the activities of these yards. Reports of independent auditors were required to ensure that this "spill-over" prohibition was fully respected. As described in full detail in the "Commission notice pursuant to Article 93(2) of the EC Treaty to other Member States and interested parties on the spill-over of restructuring aid for MTW-Schiffswerft and Volkswerft to other Bremer Vulkan Verbund AG undertakings"[1] a substantial part of the aid was, however, misused. According to the report of an auditing firm engaged by the German privatisation agency BvS for an investigation on the origin and the fate of the funds of the two yards, which had been placed in the central cash management system of the BVV group, the situation is as following (all amounts in mio DM):

Table 2: Spill-over of restructuring aid form MTW and VWS (all amounts in mio DM)

	MTW	Volkswerft
Total outstanding placed in the cash-concentration (per 21.2.1996)	577.2	268.9
of which:		
Investment aid	55.3	36.8
operating aid	268.1	60.7
closure aid	1.5	0.0
subtotal authorised aid	324.9	97.5
unauthorised aid	120.8[2]	76.7[3]
accrued interest and non aid related transfers	131.7	94.7

5. Hence, the two yards had placed 846.1 mio DM in the cash concentration system at the time when BVV had to apply for a debt composition procedure. Participation in the cash concentration system had been imposed by BVV on the yards. The management of the shipyards had virtually no influence on these placements. Claims for a recovery of the money have been filed under the bankruptcy procedure. In addition, members of the former management of BVV are sued under criminal and civil law, and parliamentary investigations have been launched to obtain a full clarification about these massive financial irregularities. The Commission has extended the current investigation procedure in order to find out if a decision should be taken on a recovery of part of the misused funds from the effective beneficiaries, either daughter companies or firms linked otherwise to the BVV group.[4]

[1] OJ No. C 150 of 24 May 1996, for extension of procedure compare OJ No.C 65 of 1 March 1997.

[2] includes investment loan of 112.4 mio DM which was foreseen under original aid programme but disbursed without approval from the Commission.

[3] includes 70.4 mio DM investment aid foreseen under the original aid programme but disbursed on a loan basis prior to the authorisation of the Commission

[4] For reference compare footnote 1

II. The development of MTW-Schiffswerft and Volkswerft Stralsund since February 1996

6. When the Bremer Vulkan group collapsed end of February 1996 the two yards were left in the middle of the restructuring with hardly any liquidity. For technical and commercial reasons neither the large scale construction works nor construction of ships could be stopped in this phase, if the yards should retain a chance for survival. Construction financing for the ships could be secured to a large extent through loans from commercial banks which were secured by mortgages on the ships and in part by construction financing guarantees. The extension of the Mecklenburg-Vorpommern guarantee scheme to provide this type of guarantees was authorised by the Commission end of February 1996 (state aid case no. N 107/96)[5]
   Funds for a continuation of the physical restructuring and for the covering of operative losses could in the first phase only be secured by the advanced sale of land no longer needed. In the case of MTW part of the investments could be financed by the release of a last tranche of 48.4 mio DM restructuring aid for MTW from a blocked account (state aid no. N 207/96)[6].

7. To secure progress of works on the yards BvS provided a number of short-term loans since May 1996. The German government took the line that these loans could not be considered as new state aid. First they were meant to replace approved state aid for the restructuring of the yards which had not become effective on the market because it was misused, and second as the loans had been given on market terms. The Commission did not follow these arguments: In its decision of 10 December 1996 to open the Art. 93(2) procedure[7] it argued that the investigations on the misuse of aid evidenced that the original payments were received by the yards and were clearly state aid, even if they were subsequently misused. Nor could it be accepted that the loans were given on market conditions when it was evident that no commercial bank would have provided such loans whose repayment is unsecured.

8. The Land Mecklenburg-Vorpommern and BvS managed finally to separate the yards from BVV after a politically and legally complicated procedure in spring and summer 1996. Since then, the two yards are owned by the Land[8] and BvS in expectation of a subsequent new privatisation. A consulting company was commissioned by BvS to undertake a fundamental review of the current restructuring concepts. In essence, the consultants came to the conclusion that in order to secure viability of the yards major organisational changes and implementation of various cost-cutting measures was needed. The employment guarantees until 1996/97 under the original privatisation agreements were no longer tenable, but a new drastic reduction of personnel was unavoidable. In view of the advanced stage of the construction works, however, only minor modifications of the investment programme were possible.

9. The notification of the state aid for the continuation of the restructuring was delayed due to difficulties to reach an agreement on the financing between the new owners. A first notification was received by the Commission on 3 September 1996. It was however

[5] OJ No. C 150/96 of 24 May 96

[6] OJ No.C 215/96 of 25 July 96.

[7] State aid cases nos. NN 102/103/96, OJ No. ......(publication in preparation) In total loans amounting to 105 mio DM were committed for MTW and 195 mio DM to VWS

[8] In the case of VWS, the city of Stralsund continues to hold 11% of equity. However, the city is not involved in the further financing of the restructuring.

incomplete, in particular as some key information concerning the planned operating aid and the foreseen arrangements for a new privatisation were missing. Apart from that the Commission felt that some assumptions determining the expected viability of the restructuring concepts could be questioned. With letter of 16 September 1996 the Commission asked therefore for further information and announced that it would have some aspects of the restructuring firms reviewed by an independent consultant.

10. The consultant visited the two yards end of October 1996. In his report he came to the conclusion that the investments undertaken were in line with the investment plan approved by the Commission under the original restructuring. The investments should, once they are completed, allow to achieve the productivity levels envisaged provided that the planned organisational changes are fully implemented. The consultant cautioned, however, that commercial viability especially of Volkswerft will depend very much on whether the yards are successful in building more sophisticated ships than the container ships on which they have to focus during the restructuring period. Success in this new product mix required however sufficient marketing and design capacity. This can either be provided from outside in the case of a take-over by an experienced shipbuilder. Otherwise it has to be provided in-house by the yards. The Commission communicated these findings to the German government and requested that this, same as a number of other issues, was to be addressed in the revised notification.

In response to the questions and observations from the Commission the German government provided revised notifications in mid January 1997 upon which the further text is based.

III. The new restructuring plans and the envisaged aid programme

11. BvS commissioned specialised consultants and an international merchant bank with the preparation of a new privatisation of the yards. In order to contact potential investors world wide, detailed documents were prepared These were sent out to a wide range of potential investors, which are considered qualified. A number of these showed interest and preliminary discussions have been started. The German government feels that there are good prospects to find one ore several buyers which are willing to take over the yards and to operate them successfully. In the worst case, however, a temporary stand-alone solution is also considered as viable, notwithstanding the sincere intention to reach a privatisation. For the time being the German government sees, however, no chance to indicate a definitive timetable for the conclusion of the privatisations and their outcomes, the more so, as this depends to a large degree on the decisions of the Council and finally the Commission on the various state aid aspects.

12. Obviously, the definitive production programme of the two yards will depend largely on the results of a future privatisation as well. Especially if the buyer is an established shipbuilder, he will allocate contracts to the yards in consideration of the combined production capacities of his group. The orderbooks for 1997/8 with their strong dominance of smaller container ships reflect the technical limitations of the yards during the restructuring as the dock of MTW and the shiplift in the case of VWS are still under construction. To a certain extent, the orderbook particularly of VWS, is a heritage from the BVV period as a number of contracts were concluded in 1995 on fairly unfavourable terms. Both yards take active steps to diversify their production programme, the more so as the container ship market seems to be weakening. MTW obtained a contract on a medium size cruise vessel and two ice-breaking tankers and is in negotiation about further orders of this type. The efforts for diversification are less advanced in VWS, but first results have been as well by contracts for two combi-freighters and a dredger and several projects under negotiation. The yards expect therefore for the coming years a better market position and a decreased dependency from the container ship market. Notwithstanding to this, the two yards with their modern facilities expect to be able to produce container vessels at market prices after full completion of the restructuring.

13. The financial scope and the principal technical elements of the investment programmes remain almost unchanged. While the consultants of BvS reviewed the programmes in depth in view of potential cost savings, they came to the conclusion that it was too late for major modifications. The vast majority of the contracts had already been placed and works have started on all major investments. Apart from that, it was found that commercial viability of the yards could not be achieved without the investments. This argument is particularly important for VWS which needed to be changed from a yard equipped for fishing vessels to a modern multi-purpose yard for larger ships. According to the revised estimates, total investment costs will increase by about 7% in comparison to the plans in 1992/3. In both yards part of the cost increase is caused by claims of contractors related to the collapse of BVV(eg claims for interruptions of works and for late payments). In the case of MTW the remainder was caused by difficult subsoil conditions, while in the case of VWS the investment programme was slightly modified to increase the flexibility of the yard. The following table gives an overview of the old and new investment budget.

Table 3:Investments of MTW and VWS

	MTW	VWS
Total investments foreseen under the original restructuring programme (1992/93)	562.2	637.0
cost increases and modifications	36.0	42.0
Total investments foreseen under the revised restructuring programme (1997) w/o contingencies	**598.2**	**679.0**
of which		
paid until end 1995	233.5	286.4
paid in 1996 (provisional)	148.1	158.7
to be paid in 1997	169.6	175.1
to be paid 1998	47.0	47.8
to be paid 1999/00	0.0	19.8
contingencies	20.0	8.7

The above table shows that the investments are already very advanced and that the programmes will be virtually completed by end of 1998.

14. While the changes in the investment programmes are relatively minor, the financing of the costs changes fundamentally: First, the own contribution which was expected from BVV has now to be met by the state as new owner. Second, the shortfall due to the misuse of some of the investment aid has to be met from the state as well. In an overview the total financing situation is therefore as following:

Table 4: Financing of the investments of MTW and VWS

	MTW	VWS
Total investments foreseen (with contingencies)	618.2	687.7
total (cash) investment aid released under the original programme until end 1995	288.8	380.0
of which misused	-55.3	-107.2[9]
investment aid actually received and used under the original restructuring programmes until end 1995	233.5	272.8
financed from own sources (1995/6)	10.9	13.6
residual funds of original programme released in April 1996 (state aid case no. N 207/96)	48.4	-,-
new funding envisaged	325.4	401.4
of which		
Loans from BvS/Land MV (on concessional conditions)[10]	129.4	147.0
Grant aid (Inv.-Zuschüsse)	176.0[11]	245.7
Contingencies (potential. aid)	20.0	8.7

15. The revised restructuring plans envisage a drastic reduction of labour costs to gain competitiveness. To this end an agreement was reached with the staff on a substantial reduction of wages. In addition, staff will be reduced in steps until end of 1999 from 2029 to 1128 in VWS and from 1859 to 1184 in MTW. It is argued that this reduction is caused by the strict limitation of capacity and therefore production of the yards. At the same time the increased competitive pressure forces the yards to limit staff to the absolute minimum. The new and additional lay-off of personnel is very painful in the present situation of the labour market. It is therefore to be assisted by a social package of 50.2 mio. DM in the case of VWS and 26.5 mio. DM in the case of MTW. Payments under this package are strictly limited to severance payments (the amount varies according to social criteria) and costs for temporary employment in the communal sector and retraining to find employment outside of shipbuilding. For this purpose so-called "ABS-Gesellschaften"(employment firms) have been created, same as in comparable cases in the region.

16. The operating aid given to the yards under the original restructuring programme had basically three purposes: (a) to cover losses under contracts concluded under the old regime (before 1.7.1990), (b) to cover losses on contracts to be handled during the restructuring period (when productivity gains from the restructuring are not yet achieved and production is impeded by the reconstruction works) and (c) to provide a reasonable working capital base for the yards. The first reason is no longer relevant. However, the second and the third are still relevant.

[9] includes 70.4 mio DM investment aid which was paid as loan prior to release of aid by Commission (comp. C7/96)

[10] The concessional elements consist of an interest free grace period of about 2 years and soft repayment terms (7% interest + 1% repayment as from the year 2000)

[11] includes "Abgrenzung MwSt" DM 3.8 Mio

The notifications show that both yards face considerable additional production costs until end of 1998 as key components (mainly the dock and the shiplifts) of the installations are not yet completed.
In addition, the two yards were stripped of all free liquidity and liquidable assets in the course of the financial breakdown of BVV and due to the misuse of funds. Hence they lost all their working capital and all there reserves which should have been served to cover pending losses under existing contracts.
On top of that they lost also some advance payments from clients through the cash concentration system. As the yards have no working capital left and no securities to offer, they have no access to bank financing unless an external guarantee is provided. State guarantees are also needed to secure advance payment and performance bonds as no commercial bank is presently willing to provide such guarantees without a cash deposit or a counter guarantee from the owners. According to the notification, it is planned to address this problem first by the provision of state guarantees not only for the usual construction financing but also for a working capital credit line and advance payment and performance bonds. In case this proves to be not sufficient the notification foresees that an increase of equity by an amount of 50 mio DM in MTW and 60 mio DM in Volkswerft will be provided. These amounts have therefore the character of contingencies.

Same as all other yards in Germany MTW and VWS are to receive contract related aid in the form of grants under the "Wettbewerbshilfe"scheme.
In an overview the amounts of operating aid, including the social aid package described above, are given in the following tables:

Table 5: Total operating aid foreseen for MTW

	1996 (act.)	1997	1998	1999	2000	96/00
A. Operating aid linked to the restructuring						
A.1 Aid to compensate excess production cost	65.783	38.233	24.051	0.0	-2.790	125.277
A.2 Social aid	2.817	5.520	10.920	4.500	2.790	26.547
Subtotal A	68.600	43.753	34.971	4.500	0.0	151.824
B. Operating aid equivalent of guarantees						
B.1 construction financing[12]	1.061	2.393	6.918	10.861	10.482	31.715
B.2 advance payment bonds	0.0	3.439	1.187	0.0	0.0	4.626
B.3 performance bonds	0.0	1.669	1.689	1.176	0.502	5.036
B.4 working capital credit line	0.0	1.500	1.500	1.500	1.500	6.000
Subtotal B	1.061	9.001	11.294	13.537	12.484	47.377
C Wettbewerbshilfe	25.445	41.513	29.227	17.842	7.244	121.271
Total operating aid (without contingency)	95.106	94.267	75.492	35.879	19.728	320.472
For ease of reference: turnover[13]	544.322	562.493	485.992	493.479	474.796	2.561.082
total aid / turnover (%)	17	17	16	7	4	13
total aid/turnover in period 1996/98		17				
D. Contingency						
potential Increase of working capital through increase of equity						50.000
Total operating aid including contingency						370.472

[12] contract related aid, aid equivalent 10% p.a. of guaranteed amount, in accordance of the "10% rule" applicable in the shipbuilding sector
[13] Gross turnover +/- works in progress, minus "Wettbewerbshilfe"

Table 6: Total operating aid foreseen for VWS

	1996 (act.)	1997	1998	1999	2000	96/00
A. Operating aid linked to the restructuring						
A.1 Aid to compensate excess production cost	65.042	57.631	5.365	-0.09	0.0	128.029
A.2 Social aid	5.233	35.772	9.091	0.09	0.0	50.186
A.3 Claims against BvS[14]	0.0	0.0	38.407	0.0	0.0	38.407
Subtotal A	70.275	93.403	52.863	0.0	0	216.541
B. Operating aid equivalent of guarantees						
B.1 construction financing	1.500[15]	13.200	13.540	10.950	8.510	46.200
B.2 advance payment bonds	0.0	2.589	1.224	0.0	0.0	3.813
B.3 performance bonds	0.0	2.800	2.800	2.800	1.400	9.800
B.4 working capital credit line	0.0	1.500	1.500	1.500	1.500	6.000
Subtotal B	1.500	20.089	19.064	15.250	11.410	67.313
C Wettbewerbshilfe	8.653	31.018	23854	15.144	6.648	85.317
Total operating aid	80.428	144.510	95.781	30.394	18.058	369.171
For ease of reference: turnover[16]	399.512	418.617	400.049	361.581	338.654	1.918.413
total aid / turnover (%)	20	35	24	8	5	19
total aid / turnover (%) in period 1996/98		26				
D. Contingency						
potential increase of working capital through increase of equity						60.000
Total operating aid including contingency						429.171

In the case of MTW the total new operating aid linked to the restructuring[17] amounts to 167.5 mio. DM and is considerably less than the amount of operating aid under the old programme which got misused. In the case of VWS the amount of new operating aid linked to the restructuring is 236.2 mio. DM, against 60.7 mio. DM misused. The tables above show further that due to the new operating aid the ceiling is exceeded in the period 1996/98 while the current ceiling would be respected in 1999 and 2000 unless the contingency amounts will be paid in one of these years.

17. According to the new restructuring concept, BvS and the Land Mecklenburg-Vorpommern finance as new owners the completion of the restructuring. Insofar they adopt the role of Bremer Vulkan Verbund (BVV). In parallel all claims of the yards

[14] The nature and the justification of these claims is still under examination by BvS, according to the notification the claims are related to social aid for 1995 and unrecoverables from Schiffscommerz

[15] preliminary estimate

[16] for definition cp. footnote 10

[17] I.e. total aid (before contingency) minus Wettbewerbshilfe and construction financing guarantees. These two items are to be deducted as these forms of aid are available for all German yards up to the aid intensity of the ceiling.

against BVV which were filed under the bankruptcy procedure (846.1 mio DM see point 4 above) are ceded to BvS, and BvS waives all claims against the yards. Such claims exist concerning:

- an investment loan of 112.4 mio DM given by Treuhandanstalt (now BvS) to MTW which was not used for investments but was transferred to BVV
- investment aid on an amount of 70.4 mio DM and 0.4 mio.DM closure aid foreseen under the original aid budget of Volkswerft but disbursed as a loan from BvS prior to the release by the Commission and misused in the cash-concentration system
- regional development aid provided under the "Gemeinschaftsaufgabe" scheme on an amount of 8.15 mio DM (MTW) and 6.3 mio. DM (VWS) which should have been retransferred to BvS but were placed in the cash-concentration system of BVV[18].

By this arrangement it is avoided that the financial situation of the yards is influenced by any repayments potentially made at the end of the bankruptcy procedure of BVV which will now be made in favour of BvS and not to the yards.At the same time it is avoided that the budget is inflated by provisions for repayments of the above claims which would have to be financed by the recipient BvS, what obviously would make little sense.

18. The German government gave the undertaking that no further restructuring aid, rescue aid, loss compensation or aid for privatization on top of the amounts notified now will be provided for the yards. If one compares finally the amounts of the yards lost in the cash concentration system and the total amounts now needed for the completion for the restructuring the situation is as following:

Table 7: Comparison of misused funds and new aid required (mio DM)

	MTW	VWS	Total MTW+VWS
amounts lost in the cash concentration system	**577.2**	**268.9**	**846.1**
of which authorised aid	324.9	97.5	422.4
total new aid notified[19]	**449.3**	**590.3**	**1039.6**
of which			
investment aid	231.8	294.1	525.9
new social aid	26.5	50.2	76.7
operating aid	141.0	186.0	327.0
potential increase of equity (contingency operating aid)	50.0	60.0	110.0

[18] additional amounts of 5.65 mio DM (MTW) and 6.0 mio. DM (VWS) were used for investment financing in early 1996; these are contained in the investment budget

[19] Aid intensities and aid equivalents as calculated by the Commission (compare Tables 4/5/6)

IV. The Commission Proposal

19.In the explanatory memorandum to the proposal of the Commission for the later Council Directive 92/68/EEC which provided the special rules for the restructuring of the shipyards located in the former GDR,[20] the commission set out that a balance had to be found between the regional development and employment interests, for which the modernisation of east German shipbuilding is desired and the possible negative influence on the competition situation of other Community yards resulting from the aid given for the modernisation. This general principle applied by the Commission and the Council in all major restructuring cases, in particular when a derogation under the respective Directive on aid to shipbuilding is required, has to be applied concerning the new restructuring programmes for MTW and VWS as well. An application of Article 92,2 (c) of the Treaty is considered as not appropriate by the Commission. This legal provision was not invoked for the original programme. It is not appropriate to apply this provision in the new case as the need for continued aid does not result from the partition of Germany but the particular mishaps described above. The Commission can accept that many of the arguments of the original derogation are still valid. Nevertheless, a review is called for in the light of the developments in the past few years.

20.The structural problems in Mecklenburg-Vorpommern persist. All east German Länder are now classified as regions to be considered under Article 92, 3 (a) as areas where the standard of living is abnormally low and where there is serious unemployment. In fact, Mecklenburg-Vorpommern is the poorest Land in the east of Germany. As the number of jobs in agriculture and industry decreased further since 1992, the unemployment rate of 18.0 % is far higher than on average in Germany and the Community, and that, although the region faced a high level of emigration in the past few years. According to recent forecasts economic growth will be very limited in the next years. This general picture applies also to Wismar the location of MTW and Stralsund the location of VWS. In both regions the shipyards are the principal employers and large parts of the local economy are linked to them. A closure of the shipyards would be for both cities a disaster as the perspectives to create new local employment are bleak in general, and even more so for the specialized staff of the shipyards.

21.The perspectives for Community shipbuilding for the next few years look less positive than in 1991/92. The sector is plagued by persisting overcapacities as new capacities come up mainly in Korea and China, and the price level for new ships remains depressed. This has created severe difficulties for a number of Community yards in the recent past and in quite a few cases these difficulties continue.

[20] SEC (92) 991 final, dated 25 May 1992.

22. On the other hand, it would appear at this stage that the new aid for the completion of the restructuring of MTW and VWS will have no new impacts on competition in comparison to the originally approved programme. The capacity limitations of 100000 cgt for MTW and 85000 cgt remain unchanged. They are in force since 1 January 1996 and will be applicable for the same period as stipulated under Article 7 of the Seventh Directive (i.e. minimum 5 years, maximum 10 years). The actual production in the years 1995 and 1996 was less than 10% below this capacity limitation, as the yards tried to compensate their reduced technical production capacities during the restructuring by a higher staff input than which will be realised later. It seems therefore reasonable to assume that the impact of the continuation and completion of the restructurings on the market will be very limited.

23. In this context, it may be also considered that the German government announced that the Bremer Vulkan Werft in Bremen-Vegesack will be closed totally for newbuilding of merchant ships as from summer 1997. Before the start of the financial crisis of the group, this yard employed almost 2000 staff. It is equipped with two dry docks and three slipways. The first dry dock has a dimension of 337m by 57m for construction of vessels of of up to 300 000 dwt. The second dry dock is covered and has a dimension of 170m by 25m for ships up to 25 000 dwt. Two of the three slipways are taken out of active use since 1988. The third one can accommodate ships up to 250m length and 32m width. According to information from the yard, its total capacity amounts to 225 000 cgt. While this figure may represent the maximum attainable capacity rather than the active capacity, it is clear that the closure of the Bremer Vulkan Werft will result in a substantial reduction of German shipbuilding capacity.. In addition, German shipbuilding capacity will be reduced further by a partial closure of Schichau Seebeckwerft in Bremerhaven. The court administrator and the Land Bremen have, however, not yet taken a definitive position on the future of this yard in bankrupcy.

24. A major part of the aid to be given for a completion of the restructurings replaces aid which was originally already approved but was not used for the intended purpose as it was misused. In fact, from the investigations on the spill-over and misuse of aid[21] it became evident that the misuse occurred beyond the control of the yards but through actions of the former management of their former mother company BVV. In addition, the yards lost own funds due to these imposed tranfers. BvS has filed claims for repayment of the withdrawn funds (not only the aid part) under the bankruptcy procedure of BVV. The Commission investigates the recovery of the aid , seeking for the recovery of the misused aid from BVV, and, if appropriate against companies formerly linked to the group who actually benefited from a major part of the misused amounts. It would be difficult to reject consideration of any further restructuring aid, given that the yards were not responsible for the misuse of aid and that they and their staff faced already a substantial consequential damage, going considerably beyond the scope of the misuse. Notwithstanding to this, the Commission takes, however, the view that the aid foreseen for the completion of the restructurings needs to be considered as new aid requiring a new authorisation.

25. As set out in Chapter III of the Seventh Directive, the prime condition for restructuring aid to shipyards is the existence of a restructuring plan which does not involve an increase in the shipbuilding capacity. It is shown above, that the capacity of the yards will remain unchanged. However, the more advanced understanding of the capacity concept for shipyards and new practices in the industry, such as extended outsourcing and subcontracting, leads to the conclusion that the capacity of a shipyard depends not only on

[21] state aid case no. C7/96 , for reference see footnote no 1 above

the dimension of the key installations but also on the actual production programme and the organisation of production. The Commission and the German government agreed therefore, that the respect of the capacity limit of the east German yards will be enforced by a strict control of production. The Commission will seek technical assistance to check the results of the established monitoring system.

26. In contrast to the situation in 1992, very detailed restructuring plans are available now as the works are half completed. The financial calculations should therefore have a high degree of accuracy. Remaining risks as regards the restructuring costs were addressed by the provision of contingencies which will only be used if necessary. After completion of the investments, both yards will have modern and flexible facilities which allow a high level of productivity. The principal risks concerning the viability of the yards after restructuring are, however, less linked to the investments but to the development of the market and, particularly in the case of VWS, the successful implementation of the reorganisation of the yard, which is absolutely necessary for the achievement of competitive production costs. Obviously the important market risks typical for shipbuilding cannot be eliminated. Both yards have taken measures to reduce their dependency from container ships which is partly a heritage of the BVV period.
Diversification and reorganisation measures are more advanced in MTW. In this case the information provided shows convinvingly that the enormous loss of 577 mio. DM placed in the cash concentration system is the reason why further aid is needed. Apart from that the yard is reasonably well positioned on the market.
In the case of VWS the situation is more complicated. It needs to be recalled that this yard had a difficult starting position as it was specialised on fishing vessels for the former Eastern Block. It was only privatised in 1993 and needs a complete reorientation. It was clear from the beginning that considerable time would be needed for this process. In fact, the privatisation agreement envisaged that the first phase of the restructuring to be financed mainly from state aid would run until end 1997, while the second phase to be entirely financed from BVV would run until 2005. From hindsight, some aspects of this phased restructuring can be questioned. It is also clear that not only money but also valuable time was lost due to the disturbances caused by the collapse of BVV. In areas like marketing VWS was much closer linked to BVV than MTW. Important changes in management took place only some months ago. As set out in the notification and in the reports of the management consultants the steps taken in management and for rigorous cost control have improved the yard's perspectives. Diversification has however also its risks, mainly in form of cost-overruns, but also as VWS is not yet fully established on the envisaged markets. Notwithstanding these risks, the Commission can accept the revised restructuring programme as realistic and viable.The advanced status of construction needs to be taken in consideration as well. In view of the risks the Commission considers, however, the continuation of the intensive monitoring, meanwhile established by BvS, for both yards as indispensable. In addition, the Commission will take measures including visits of the sites to monitor that the conditions of the aid and the capacity limitation are respected in agreement with the Member State.

27. The Commission takes the view that the entire envisaged operating aid should be assessed under Chapter II of the Seventh Directive, even if the social aid part is normally assessed under Article 7, and it could be argued that some of the aid foreseen to cover excess cost of production during the restructuring is from a technical point of view directly linked to the investments and should therefore considered as restructuring aid under Chapter III. The reasons for that are, that for an application of Article 7 (Closure Aid) a partial or total closure of the same yards is necessary. This condition is not met here. The excess costs of

production during the restructuring are rather consequential costs than costs directly linked to the investment as required in Article 6(3).
The total envisaged operating aid needed for the completion of the restructurings exceeds in the period 1996/98 the current ceiling of 9% of contract value before aid (Article 4)[22] and of turnover (Article 5) as set under the Seventh Directive. Therefore, a derogation from the provisions of chapter II of the Directive is necessary for this period. For reasons of legal clarity, the Commission proposes further to stipulate the maximum amounts of aid to be permissable for the completion of each restructuring in the text of the derogation and not to work with a ceiling expressed as a percentage of future turnover. While a certain flexibility for reallocation of amounts under the individual items is necessary due to changes in contracts, no reallocation of the social aid or investment aid for other purposes shall be possible.In its evaluation of the notifications the Commission will assess the justifcation and necessity of the actual amounts of operating aid to be disbursed, and in particular the use of the contingencies.

28. The investment aid foreseen for the completion of the restructurings will be evaluated under Article 6 of the Seventh Directive. As discussed above, this provision requires that the aid is linked to a restructuring plan which does not involve any increase in the capacity of the yards. In addition Article 6(3) requires that the aid intensity is justified by the extent of the restructuring involved and that the aid is limited to supporting expenditure directly related to the investment. At this stage it can be said that the investment aid and the loans foreseen cover the direct costs for the physical modernisation of the yards. The investment plans are fully specified and the vast majority of the contracts for the works are under implementation. It appears that uncertainties about the final costs are therefore very limited. As part of its evaluation, the Commission will require evidence about the nature and amounts of the expenditure as a condition for release of the investment aid.
The aid intensity which was already exceptionally high under the original restructuring concepts increases further, due to the fact that the originally envisaged contribution of the private investor has now to be taken over by the state. As the yards have hardly any equity left, and as the financial returns of the investments are limited and volatile due to high sectoral risks, a financing of the investments on a loan basis is only partly possible. For this loan part the yards will pay interest from the year 2000.
In view of the particular history of the projects, the Commission is at this stage of the opinion that it could can approve the investment aid under Article 6 of the Seventh Directive once the derogation has been approved by the Council for the operating aid foreseen.

29. The Commission takes note of the waiver of all claims from earlier loans to MTW and VWS and out of misused funds under the "Gemeinschaftsaufgabe" scheme, and of the ceding of all claims on deposits of the yards in the cash-concentration system of BVV to BvS.

14.3.97

[22] The ceiling of 4.5% for smaller vessels and for conversions can be disregarded here, as the yards will be hardly involved in such contracts.

Derogation for Greece to grant aid towards the restructuring and privatization of the Hellenic shipyard

I. Background

Article 5 of the Council Directive 90/684/EEC provides for operating aid to be granted for shipbuilding yards up to the ceiling for contract-related production aid which is annually set by the Commission. This ceiling has remained unchanged at 4.5% and 9% of the contract value respectively for ship conversion and newbuilding up to 10 MECU and for newbuildings equal or above 10 MECU.

Article 10 of the Directive excluded Greece from this ceiling and allowed operating aid to be paid by Greece to public yards, if linked to their privatisation until 31.12.1991.

II. The Privatisation of Public shipyards in Greece - Article 10 of the Directive 90/684/EEC.

On the basis of the undertakings given by the Greek Government that its public yards would be privatised by 31 March 1993, the Commission accepted, on 23 December 1992[1], that the write-off of the debts of the four yards concerned by Article 10 of the Directive - in the amounts notified to it - was compatible with the provisions of Article 10.

The Elefsis Shipyard was sold in July 1992[2] and the Nafsi Shipyard in 1993[3]. Failing the Greek Government to meet its commitments on time and after considerable delays, the Commission refused to prolong the deadline and initiated, on 16 February 1994[4], proceedings pursuant to art 93(2) EC in respect of the aid granted by Greece to the remaining two yards, because Hellenic and Neorion were, at that time, still under State ownership.

In summer 1994 the Greek Government succeeded to sell the Neorion Shipyard and informed the Commission with a letter dated 19 October 1994. The Commission tried to show flexibility with respect of the repeated efforts of the Greek Government to find a solution with the privatisation of the Hellenic but at the same time continued to contemplate all legal possibilities to ensure the enforcement of the Directive. For this reason, on 26 July 1995, the Commission decided[5], to close the procedure under Article 93(2) EC, with a positive decision for the aid to Neorion and a negative decision concerning the aid to the Hellenic.

However, at the request of the Greek Government claiming that the sale of the yard was imminent, the Commission decided to suspend the notification of that decision. In

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[1] .OJ No C 88, 30.3.93.

[2] sale already acknowledged in the Commission decision of 23.12.1992.

[3] as informed by the Greek Government by letter dated 2/6/93.

[4] OJ No C 138, 20.5.94.

[5] PV(95) 1258, 26.7.1995, SEC(95) 1322/2, 24.7.95.

its September meetings the Commission put off twice the execution of the July 1995 decision.

In September 1995, the Greek Government notified to the Commission the sale of 49% of the Hellenic Shipyard's shares to a co-operative of the yard's workers. By doing so Greece made use of paragraph 3 of Article 10 of the Directive which allows it to maintain a 51% majority holding in one of the yards if justified by defence interests. The process of privatisation was completed on 31 January 1996, when the court of Appeal in Athens ratified an agreement concluded between the creditors of the yards and set the amounts and conditions for the write-off of the yard's debts.

Following the sale of the yard, a business plan providing for the restructuring of the yard and its modernisation has been put into place. The number of employees is going to be reduced from 2966 to 2000 and, after a planned investment for its modernisation, the yard is expected to return to profitability in 1998. As part of the privatisation and restructuring process, in September 1996, following an open bid, the management of the yard was awarded to a private independent company. This private company has been running the yard since then, with its main task to implement the business plan.

The conditions for the Commission to approve the aid for debts' write-off for the Hellenic yard seemed to be met. However, the amount of debts to be written-off has, as informed by the Greek Government, increased due to interests produced by the existing debts on the 31.12.91 (GDR 44 billion) and accumulated until 31.01.96. The current debts of the yard amount to GDR 112.6 billion. Out of this amount, GDR 11.765 billion concern current business of the yard and will remain in its accounts. GDR 46.355 billion correspond to credits for the building of military vessels, activity which is outside the scope of the EC Treaty. This leaves GDR 54.525 billion, that the Greek Government cannot write-off without the prior Commission's approval. This amount exceeds by GDR 10.525 billion the aid approved by the Commission in 1992.

The new accrued debts (GDR 10.525 billion) are part of the liabilities of the yard. Although related to the initial approved amount, the Commission considers that aid to cover interests on an approved aid, but which was not paid, constitute new aid as long as the potential aid beneficiary has not been released from his liabilities for the initial debts. The Commission considers that the payment of the new amount would correspond to operating aid. The Directive does not provide for a legal basis to approve such type of aid and Article 10 provided for such possibility only until the end of 1991. On the other hand the new aid cannot be approved, under Article 5 of the Directive, because the aid amount exceeds the applicable ceiling.

The Greek Government maintains that the aid is essential for the survival of the yard and to sustain the effort made to complete the restructuring of the Greek shipbuilding sector. They stress the importance of securing the operation of reliable ship repairing units in the eastern Mediterranean basin which constitutes a substantial market not covered sufficiently in this sector.

The business plan prepared to allow the company to reach its viability, is already in place but its success depends upon the effective and on time implementation of all measures. It is based on the assumption that the debts of the yard will be written off as

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approved by the decision of the Greek Court of Appeal. An important investment plan is foreseen to be shortly implemented in order to modernise the yard.

It must also be noted that the uncertainty regarding the clearance of the yard's debts makes the banking institutions reluctant to grant any further credit to the yard putting thus in risk the whole restructuring process.

III. Assessment by the Commission

The shipbuilding industry is of strategic importance for Greece due to the high number of workers involved (almost 9 000) and the geography of the country where most communications between the many islands depend on maritime transport.

The Commission acknowledges the important effort Greece has made by trying to find a solution for the privatisation of all its yards within the framework of the Directive. For this reason, the Commission has accepted the delay in the disposal of the yards by sale but considers that the Directive does not provide a legal basis for it to approve aid above the amounts approved in 1992 which correspond to the debts existing on 31.12.1991.

Considering, however, that the conditions for the yard to become viable have been met and in view of the social and strategic importance of that yard for the region and the whole country, the Commission takes the view that it is reasonable to provide a basis for declaring compatible aid for debts' write-off to cover the debts existing when the privatisation took place and in the amounts as ratified by the Greek Court.

Derogation for Spain to grant aid towards the restructuring of the publicly-owned yards

1. Background

1.1 During the closing stages of the negotiation of the OECD agreement respecting normal competitive conditions in the commercial shipbuilding and shiprepair industry, Spain outlined plans for additional restructuring of its shipbuilding industry, entailing further substantial workforce reductions and a capacity reduction of 30,000 cgrt (from 400,000 cgrt to 370,000 cgrt).

1.2 Accompanying note 1 to Annex II of the agreement[1], which has not yet entered into force, provides for a derogation for certain Member States, including Spain. The derogation provides that in Spain's case restructuring aids up to 180 billion pesetas may be paid up until 31 December 1998, made up as follows:

(a) assistance for social measures;

(b) assistance for restructuring costs incurred before the date of the agreement, committed by the Spanish Government, and approved by the Commission before that date, but have not been paid due to budgetary problems;

(c) other assistance committed and paid on the basis of costs incurred before 1 January 1996 or investment assistance paid after 1 January 1996 (up to a maximum of 10 billion pesetas).

1.3 In November 1995 the Spanish authorities notified the Commission of its plans under the derogation to grant aids in support of the restructuring of the publicly-owned yards within the División de Construcción Naval (DCN), up until 31 July 1995 part of the Instituto Nacional de Industria (INI), but now part of the State owned holding Agencia Industrial del Estado (AIE).

1.4 The aid notified was made up as follows:

	billion pesetas
Outstanding previously approved loss compensation aid, but not paid due to budgetary constraints, as at 31 December 1994 (capital + interest)	89.104
Social aids	80
Investment	10

1.5 In December 1995 the Commission decided[2]:

- to approve the 89.104 billion pesetas loss compensation aid as being in accordance with Article 5A of the shipbuilding aid directive (90/684/EEC, as amended by Directive 94/73/EC)[3];

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[1] OJ C375 of 30 December 1994, p3

[2] OJ C 75 of 15 March 1996, p. 2

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- to open the Article 93.2 procedure in respect of proposed future tax credits amounting to approximately 48 billion pesetas in the period 1995-1998, which could constitute an additional aid; and

- to continue its preliminary examination of the remaining aspects of the case (the 80 billion pesetas social aid and 10 billion pesetas investment aid, plus additional payments totalling a further 62 billion pesetas apparently already made in the period 1988 to 1994 to cover interest charges on unpaid loss compensation aid, contract-related production aid and restructuring aid).

1.6 On 8 January 1997 the Commission decided to extend the Article 93.2 procedure[4] in order formally to investigate the remaining aspects above; plus extraordinary payments of 7.355 billion pesetas in 1991 and 1993, possible aids since the plan was notified to enable the yards to continue to operate despite mounting losses, and the compatibility of the Astano yard's activities with the condition attached to a 1991 aid authorisation[5] that the yard should be closed to shipbuilding.

1.7 Against this background, during the course of February and early March, Spanish Government has submitted supplementary information including a revised restructuring plan together with further and updated details of the public financial assistance measures involved.

1.8 Since these measures include aid elements that are incompatible with the shipbuilding aid directive, a derogation from the directive is necessary before these measures could be approved by the Commission.

1.9 This communication outlines the Commission's proposals as regards such a derogation, including the conditions that would be attached thereto.

2. <u>The Spanish public yards</u>

2.1 According to information provided by the Spanish authorities at the time of the request for the OECD derogation, the public yards had a total capacity of 240,000 cgrt and comprised three large yards (Puerto Real, Sevilla and Sestao) with a combined capacity of 195,000 cgrt and three medium sized yards (Juliana and Barreras, plus Astander) with a combined capacity of 45,000 cgrt. The balance of Spain's 400,000 cgrt total shipbuilding capacity was in the private sector yards (21 yards), with a combined capacity of 160,000 cgrt.

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3 OJ L351 of 31 December 1994, p10

4 OJ C 53 of 22 February 1997, p. 3

5 Case C 26/89, OJ C 66 of 14 March 1991, p. 10

2.2 As at 31 December 1994 the public yards and their activities were as follows:

AESA Puerto Real	Newbuilding
AESA Cádiz	Repair and conversions
AESA Sevilla	Newbuilding
AESA Sestao	Newbuilding
Astander	Repair and conversions
Juliana	Newbuilding
Astano	Offshore and repair
Barreras	Newbuilding

Astano, which had a capacity of 135,000 cgrt, is supposed to be closed to newbuilding until March 1997 as a condition of the 1991 loss compensation aid authorisation.

2.3 Since just prior to Spain's accession to the Community there has been a number of efforts to restructure the Spanish shipbuilding industry. Since 1984 there has been a reduction in capacity from 1 million tons to cgrt to 400,000 cgrt as referred to paragraph 2.1 above. During the same period there was a reduction in the workforce from 40,000 to 14,750 (as at 31 December 1993).

2.4 To facilitate this restructuring process, under the Sixth and Seventh shipbuilding aid directives up until 1 January 1992 Spain was exempted from the general operating aid rules laid down under the directive, provided that the restructuring effort continued and the aid level was progressively reduced. In addition to these aids, the Commission authorised in 1991 (case C 26/89) loss compensation aid to the public yards covering the years 1987 to 1992 amounting to 126.779 billion pesetas.

2.5 Despite the various measures taken, the publicly-owned yards continued to experience serious financial problems due to a number of factors such as the prevailing difficult market situation (characterised by a high level of under-activity at the yards) as well as delays in the receipt of aid payments due to budgetary constraints.

The public yards have therefore continued to make substantial losses, as shown in the following table

	1990	1991	1992	1993	1994
Turnover	91,478	98,283	106,137	95,593	85,983
Net loss after tax	9,179	6,654	15,843	32,525	27,221

2.6 During this period the after tax losses were approximately 28% lower than losses before tax since INI was able to use DCN's losses to offset profits elsewhere in the group, with DCN benefiting from the resulting tax credits. (The turnover figures include aids received in the form of contract-related operating aid and restructuring aid, but not loss compensation aid).

2.7 Operating losses in 1995 and 1996 were of the order of 40 billion pesetas and 37 billion pesetas respectively.

2.8 Against this background, during the course of 1995 a further restructuring plan for the public yards was drawn up. Parts of this plan, particularly as regards workforce reductions, have already been implemented as from 1 January 1996. Other elements of the original plan have been reinforced through additional measures.

2.9 The objective of the restructuring plan is a return to break even results by 1998, both at the level of individual yards and at the level of DCN as a whole. The key elements of the plan can be summarized as follows:

- restructuring of the corporate structure so that each yard is treated as a separate entity

- a reduction in costs of material supplies of 8%

- a reduction in the workforce from 10,017 at the end of 1994 (compared with over 25,000 in 1984) to 6100 at the end of 1998 (of which only 3789 will be engaged in newbuildings)

- a wage freeze in 1997 and 1998

- greater flexibility in working practices and increased employee mobility between yards

- based on the current orderbook and further contracts signed and under negotiation, to make optimum use of available capacity

- investments in improved technology

- a 35% increase in newbuilding productivity (currently around 36 cgt per man year, compared with 16 cgt per man year in 1988)

- a reduction in financial charges to 4% of turnover

3. <u>Proposed Financial Assistance</u>

3.1 It is proposed that these further restructuring measures would be underpinned by public financial assistance totalling 179.104 billion pesetas, made up as follows:

	billion pesetas
(i) Social aids	80
(ii) Investment aids	10
(iii) Loss compensation from the past	89.104

Social Aids

3.2 The social aids are broken down as follows:

	billion pesetas
Costs of workforce reductions prior to 31 December 1995	5.229
Costs of subsequent workforce reductions	65.777
Contingencies	8.994

3.3 A large number of the workforce reductions have already been made, the current workforce being around 7000. As at 31 December 1996, 66.816 billion pesetas of total aid had already been paid, the balance of 13.184 billion pesetas forecast to be paid in 1997.

3.4 The breakdown by yard of the workforce reductions will be as follows:

Yard	Workforce end 1994	Workforce end 1998	Reduction
Puerto Real	2031	1390	641
Sestao	2458	1230	1228
Sevilla	679	364	315
Juliana	720	450	270
Barreras	454	355	99
Astano	1971	1180	791
Cádiz	615	390	225
Astander	433	292	141
Corporate services etc.	656	449	207
Total	10017	6100	3917

Investment Aids

3.5 The investment aids totalling 10 billion pesetas are due to be paid by the end of 1997 and cover a range of investments in all yards covering inter alia, integrated engineering systems, improved production processes and product flows (including CAD/CAM), establishment of research and development centre environmental measures etc. The breakdown is as follows:

	million pesetas
Technical information	476
Plant modifications linked to improved product flows	2511
Improvement of the workshop installations and flows	1327
Adaptations for new products	900
Improvements of slipways and docks	1034
Implementation of new technologies	660
Soldering equipment	120
Improvements in environmental impact	1080
Improvements of auxiliary services	116
Improvement of plant's services	516
Adaptation of stores	77

Maintenance and replacement	277
Safety improvements	237
Quality control	26
Improvements in information systems	36
Improvements in workshops and machines for repairs	170
Improvements in engine workshop	227
Engine tooling	85
Various	125
TOTAL	10000

3.6 The breakdown by yard of these investments will be as follows:

Yard	bn PTAs
Puerto Real	1.75
Sestao	3.3
Sevilla	0.35
Juliana	0.35
Barreras	0.3
Astano	1.85
Cádiz	0.35
Astander	0.25
Corporate services etc.	1.5
TOTAL	10.0

Loss compensation

3.7 The loss compensation aid of 89.104 billion pesetas is made up of 64.196 billion pesetas covering the unpaid balance as at 31 December 1994 of the 126.779 billion pesetas loss compensation aid approved in 1991 for the years 1987 to 1992 but delayed due to budgetary constraints, plus 24.908 billion pesetas covering the interest accrued due to the delays in payment. This part of the aid package was approved by the Commission in December 1995. The breakdown by yard for these outstanding payments was due to be as follows:

Billion pesetas

	AESA	Barreras	Astano	Juliana	Astander	Total
1995	24.706	0.381	5.924	2.045	0.59	33.646
1996	30.194	0.104	1.579	1.580	0.468	33.925
1997	12.244	0.210	3.025	0.719	0.461	16.659
1998	3.476	0	1.180	0.153	0.075	4.884
Total	70.610	0.695	11.708	4.497	1.594	89.104

3.8 According to the Spanish authorities, as at 31 December 1996 only 39.376 billion pesetas had been paid. 47.047 billion pesetas is now scheduled for payment this year, with the remaining balance (2.681 billion pesetas) to be paid in 1998.

Other measures

3.9 In addition to the above measures, the Spanish authorities have informed the Commission that in the light of forecast losses in 1997 higher than those assumed under the plan, an additional capital injection of 15 billion pesetas will be necessary. Furthermore, the yards will also receive benefits from tax credits now estimated at 58 billion pesetas in the period up to end 1998 (up from the 48 bn pesetas figure subject to the Article 93.2 procedure).

(As noted above in paragraph 2.6, in the past DCN's after tax losses were reduced through the State shareholder INI, in accordance with normal Spanish practice in relation to holdings, offsetting before tax losses against profits elsewhere in the group. DCN obtained a share of the resulting tax credits. The DCN restructuring plan assumes such credits will continue to be available in the future despite the fact that since 1 August 1995 DCN has formed part of the loss making state holding company AIE).

3.10 In addition to these measures it appears that during the period 1988 to 1994 the yards received additional payments totalling 62.068 billion pesetas to cover interest on loans taken on to cover delays in the payment of previously approved aids. This sum comprises 24.325 billion pesetas relating to unpaid contract-related and restructuring aid; and 37.703 billion pesetas to cover unpaid loss compensation aid. The yards also received extraordinary payments from INI totalling 7.355 billion pesetas in 1991 and 1993 to cover the costs of workforce reductions in those years [amounting to 3.980 billion pesetas (300 workers)]; and the costs of indemnities arising from the Amoco Cádiz acident in 1978, amounting to 3.375 billion pesetas.

4. Capacity reductions

4.1 Under the restructuring plan it is proposed that a 30,000 cgrt capacity reduction in the public yards would be achieved with immediate effect through:

- the cessation of newbuilding at Astander (last vessel completed 1990), with the yard focussing exclusively on conversion and repair.
- the closure of a dry dock (146.6 m x 21.8 m) at Sestao
- the non-utilisation of a dry dock (148.7 m x 22.5 m) at Sevilla
- the closure of a slipway (60 m x 15 m) at Sevilla
- the closure of a slipway (67 m x 14 m) at Barreras.

4.2 This would result in total capacity in the public yards reducing from 240,000 cgrt to 210,000 cgrt; this being broken down by yard as follows:

	cgrt		
	Current	Proposed	Reduction
Puerto Real	80,000	75,000	5,000
Sestao	85,000	75,000	10,000
Sevilla	30,000	23,000	7,000
Barreras	18,500	18,500	0
Juliana	18,500	18,500	0
Astander	8,000	0	8,000
	240,000	210,000*	30,000

(* this overall capacity level would be respected, although variations at individual yards could be possible within the overall level).

4.3 The Spanish authorities have also given an undertaking that the Astano yard (capacity 135,000 cgrt), which in accordance with the 1991 aid authorisation referred to at paragrah 2.2 above could be reopened for shipbuilding as from the end of March 1997, will remain closed for such activities.

4.4 In addition there would be a capacity reduction of 17,500 cgrt reduction in the private sector yards through closures and/or changes of activity.

4.5 The private sector contribution would be as follows:

Yard	Capacity reduction (cgrt)	Year of closure (newbuilding)	New activities (if any)
Atlántico	10,000	1990	Total closure (dismantling of installations)
Ardeag	2,000	1993	Total closure (dismantling of installations)
Luzuriaga	2,500[6]	1995	Change of owner; now mainly conversion/repair, plus building small vessels
Mallorca	3,000	1995	Repair

5. The Commission's position

5.1 The need for a further restructuring of the publicly owned yards in Spain was foreshadowed in the OECD agreement.

5.2 Council Regulation 3094/95 is intended to give effect to the state aid provisions of the agreement. However in the absence of entry into force of the OECD agreement, Council Regulation 1904/96 states that the rules of the Seventh directive on aid to shipbuilding (90/684/EEC, as most recently amended by directive 94/73/EC) shall continue to apply until the agreement enters into force and until 31 December 1997 at the latest.

5.3 It follows that in assessing this case the Commission, while being mindful of the history of the provisions of the OECD agreement, should take the rules of the directive as its point of departure. In particular in its approach the Commission needs to establish

- whether and to what extent the public financial measures involved constitute state aids and if so whether these are compatible with the shipbuilding directive

- whether the nature and extent of the capacity reductions are sufficient counterpart to the aid to minimise distortions to competition in general and to fulfill the requirements of the directive (having regard also to the history of the OECD derogation) in particular; and

- whether measures envisaged in the plan will lead to a return to viability for the yards (to obviate the need for further aids in future).

Viability

5.4 According to the Spanish authorities, if all the measures under the plan are implemented in full, the yards should achieve viability very quickly, by the end of 1998. In any event, if any individual yard does not return to viability by that date the yard(s) concerned will not be paid any more aid except closure aid and contract-related aid

6 Reduced from 5,000 cgrt

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linked to future contracts in accordance with then prevailing rules for the shipbuilding sector. The Commission considers at this stage that this provides a sufficient test of viability and will ensure that this is achieved by making it a condition of the aid approval. This approval would also be contingent on close monitoring by the Commission, if necessary assisted by independent experts, to ensure that the necessary level of viability (ie break even) is achieved.

Capacity reductions

5.5 As regards capacity reductions, according to the Spanish authorities last year the public yards were operating at almost 100% capacity, producing some 230,000 tons. The reductions proposed can therefore be regarded as a genuine reduction in real capacity.

5.6 The Spanish authorities have also undertaken that production at the yards will not exceed the reduced capacity of 210,000 cgrt. The Commission will, assisted by independent experts, undertake a close monitoring of actual production levels to ensure that this level of production is not exceeded. In accordance with the principles of Article 7.1 of the directive this would be for a period of 10 years starting from the date of the Commission's eventual approval of the aid package.

5.7 The Commission also notes the undertaking of the Spanish authorities that the available 135,000 cgrt capacity of Astano will not reopen to shipbuilding. This will make a further significant contribution since otherwise, notwithstanding the capacity reductions proposed, there would be a large net increase in DCN's overall capacity.

5.8 There remains however a question over Astano's activities in respect of floating production storage and offloading vessels (FPSO's), which have included newbuildings and conversions.

5.9 The Spanish authorities consider that FPSOs are not vessels falling within the definition of shipbuilding under the directive. They maintain that such vessels only have power and steering capability to maintain position and to move around the production area and require tugs to move greater distances. However, the Commission at this stage continues to have doubts. In its view, FPSOs are metal-hulled seagoing vessels falling within the directive unless the completed vessel is incapable of directed movement except by external assistance or methods such as windlass and anchors.

5.10 The Commission therefore at this stage intends to seek independent technical advice so that the issue of FPSOs can be examined further within the context of discussion this Autumn on future aid policy for the shipbuilding sector.

Public financial assistance

5.11 As noted in paragraph 3.1 above, apart from the 89.104 billion pesetas loss compensation aid already approved by the Commission under Article 5A of the directive, the notified aid measures comprised social aids of 80 billion pesetas and investment aids of 10 billion pesetas.

5.12 So far as the social aids are concerned, Article 7 of the directive states inter alia that social aids to defray the normal costs resulting from the partial or total closure of shipbuilding or ship repair yards may be considered compatible with the common market provided that the capacity reductions resulting from such aid are of a genuine and irreversible nature. This condition appears at this stage to be fulfilled in this case. Similarly the unnotified 3.980 billion pesetas social aid paid in 1991 and 1993 could at this stage be regarded as falling within the overall restructuring of the yards and thus be compatible with Article 7 of the directive.

5.13 As regards the investment aids of 10 billion pesetas, according to Article 6 of the directive, investment aid may not be granted for shipbuilding unless it is linked to a restructuring plan which does not involve any increase in the shipbuilding capacity of the yard or unless it is directly linked to a corresponding irreversible reduction in the capacity of other yards in the same Member State over the same period. Such aid may not be granted to ship repair yards unless linked to a restructuring plan which results in a reduction in the overall ship repair capacity in the Member State concerned.

5.14 Since no increase is proposed in shipbuilding capacity in the yards concerned and there is a decrease in shiprepair capacity (based on workforce reductions), the conditions of Article 6 appear at this stage to be respected.

5.15 The Commission therefore concludes that it is likely that all the outstanding aids notified pursuant to the OECD derogation can be approved as being compatible with the directive, as can the social aids from the past.

5.16 There remains however the various other measures linked to the restructuring.

5.17 As regards the additional payments totalling 62.028 billion pesetas to cover interest on unpaid aids during the period 1988-94, according to the information available to the Commission this sum comprises 24.325 billion pesetas to cover interest due on unpaid previously approved contract-related production aid and restructuring aid; and 37.703 billion pesetas to cover interest on unpaid previously approved loss compensation aid.

5.18 The Spanish authorities maintain that the payments constitute a measure of a general nature applicable to any firm in such circumstances and that the State, through INI, as then shareholder of DCN, was legally obliged to make such payments. However, the Commission continues to have doubts whether there was such an obligation. The decision to make the payments appears to have been a unilateral and discretionary action.

5.19 Although the Commission recognises that the payments probably did not confer any economic benefit on the yards since the extra money was intended only to cover the financial charges incurred by DCN in obtaining loans to cover the shortfall in aid due to delays in payment, it must be concluded at this stage that the interest payments represent a new aid. This is consistent with the approach followed in relation to the 89.104 billion loss compensation aid provided for in the OECD derogation and approved under Article 5A of the directive, which similarly includes interest payments.

5.20 The directive does not provide a legal basis for approving such aids, which represent an additional operating aid in excess of the aid ceiling.

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5.21 So far as the tax credits of 58 billion pesetas are concerned, it appears that in the past, after tax losses were reduced through INI, in accordance with normal Spanish practice in relation to holdings, offsetting before tax losses against profits elsewhere in the group. The financial projections under the plan assume that such tax credits will continue to be available up until the end of 1998.

5.22 The Spanish authorities have introduced a general law applicable to all companies in such a position allowing them to receive from the state equivalent amounts to what they would have been entitled under a tax consolidation system. It is proposed that such arrangements would apply until 31 December 1999. According to the Spanish authorities such a general measure would not constitute a state aid. However, in the absence of any evidence as to who apart from the yards would be the potential beneficiaries, the Commission considers at this stage that the measure is a specific measure in favour of DCN which constitutes a state aid incompatible with the shipbuilding directive.

5.23 The proposed capital injection of 15 billion pesetas in 1997 to cover greater than expected losses is also at this stage considered to be a state aid incompatible with the directive.

5.24 Finally as regards the extraordinary payment by INI of 3.375 billion pesetas to cover liabilities arising from the Amoco Cádiz accident, the Commission acknowledges that these date back to 1978, prior to Spain's accession to the Community, and it therefore considers at this stage that the payments should not be regarded as state aid within the meaning of the Treaty.

5.25 It follows from the above that of the various aids involved, amounting to a total of 318.112 billion pesetas, 183.084 billion pesetas have been or could be approved under the shipbuilding aid directive, leaving a balance of 135.028 billion pesetas requiring a derogation, made up as follows:

	bn ptas
Interest payments 1988-94	62.028
Tax credits 1995-1999	58.00
1997 capital injection	15.00
	135.028

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