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RESTRUCTURING OF THE ITALIAN PUBLIC STEEL INDUSTRY

(Communication from the Commission to the Council)

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1. Introduction

1. On 16 June 1988, the Italian Government advised the Commission of a plan to restructure the Italian public steel industry. Starting with the winding-up of the parent company, Finsider, and its main steel subsidiaries, the plan comprises a number of industrial, commercial, financial and social measures which should allow a new steel entity, ILVA, to achieve, from 1990, adequate operating results to ensure viability.

According to the Italian Government, the implementation of the plan will entail a total financial cost of Lit 7 670 thousand million¹ for the present public shareholder of Finsider, namely, the state holding company IRI. Insofar as the financing is intended to make it possible to create ILVA by, on the one hand, repaying the Finsider debts that cannot be covered from the proceeds of the winding-up of certain assets, and on the other hand, by covering certain operating losses which Finsider would continue to incur during the winding-up procedure, the Commission is obliged to take the view that the measures comprise aid elements and are therefore incompatible with Article 4(c) of the ECSC Treaty and with the provisions of Decision No 3484/85/ECSC of 27 November 1985.

Consequently, the financing, insofar as it will be necessary can be authorized only if the Commission adopts a derogation decision which, under Article 95 of the ECSC Treaty, requires

1 ECU 4,950 million

the unanimous assent of the Council, after the Consultative Committee has been consulted.

11. Current financial status of Finsider

2. The Commission continues to believe that a steel undertaking cannot hope to attain lasting financial viability if it cannot achieve, under normal market conditions, an annual gross operating result of 13% of turnover, taking account of "normal" financial charges and depreciations, i.e. 4.5% and 7% respectively of turnover.

As in the case of other Community steel producers, it was only after an expert financial report had certified that Finsider's 1984 restructuring plan was capable of achieving this result subject to industrial, financial and social restructuring, that the Commission authorized the grant of aid to the Group.

In 1987, however, Finsider's gross operating profit was only 2.5% of turnover, and its financial charges which should have been reduced to 4.6% by early 1986, amounted to 8.2%. Its net losses thus totalled Lit 1 700 thousand million (or 17% of turnover), an increase of Lit 950 thousand million over 1986. Total debts for the whole Finsider Group, including EEC and ECSC subsidiaries, reached Lit 10 030 thousand million by the end of 1987, i.e. 104% of consolidated turnover.

It should be noted that Finsider's flat products subsidiary, Italsider, alone accounts for 58% of total turnover (Lit 6 400 thousand million out of Lit 11 000 thousand million), and for Lit 1 000 thousand million of the Group's losses in 1987. Italsider was thus the only Community flat products' producer²

² With the exception of Spanish undertakings undergoing extensive restructuring.

not to have obtained a gross profit in 1987 close to the minimum threshold fixed by the Commission.

The Group's inability to continue to finance its activities from own resources compelled it to have increasing recourse to bank loans from 1986 onwards, which resulted in the further deterioration of its financial structure and was the subject of a Commission proceeding under Article 88 of the ECSC Treaty. The Commission considered that the loans could not have been obtained without the implicit guarantee given by the State which thus constituted a State aid contrary to Article 4(c) of the ECSC Treaty.

3. Finally, on 10 May 1988, a general shareholders' meeting (the IRI has a 99.8% stake in Finsider) decided on the voluntary winding-up of the holding company Finsider and its main steel subsidiaries. This operation, to which the Commission extended its infringement proceeding referred to above, means that the IRI and its shareholder, the Italian State, are guaranteeing the Group's creditors, this time explicitly, that the principal and interest on their loans will be repaid.

At the same time, and in agreement with the Italian Government, the Commission appointed a panel of experts to analyse the reasons for the failure of the restructuring plan authorized in 1985. Concern at the failure was heightened by the fact that, whilst Finsider was undergoing major structural changes, notably in the form of capacity cuts (-23,6% of the capacity of hot-rolled products of 1980) and redundancies (employment cut by 43 200 persons, i.e. -32% in relation to 1980), it was also receiving Lit 12 000 thousand million in aid between 1980 and 1985, i.e. 27% of the total aid granted in that period to the steel industry in the Community of Ten.

As could have been expected, particularly in relation to the performance of Finsider's main competitors, the analysis

revealed that the failure was not due to outside circumstances such as price trends or production volumes³ in relation to estimates, but indeed to a still insufficiently competitive industrial and commercial structure, delays in the implementation of investments and to insufficiently rigorous management.

III. Restructuring plan of the Italian Government

4. Industrial aspects

As part of the winding-up procedure, the Italian plan divides Finsider's existing activities into three categories:

- 4.1 ECSC and non-ECSC steel activities which are or will be profitable will be transferred to a new company "ILVA", whose sole shareholder will, at least initially, continue to be Finsider. The activities to be transferred are those of Italsider (flat products manufactured chiefly at the integrated plant at Taranto), Deltasider (long products, integrated plant at Piombino), Dalmine (pipes and tubes), TDI (pipes and tubes) and Terni (stainless steels).
- 4.2 Steel activities whose profitability within ILVA cannot be guaranteed will either be closed down or sold to the private sector.

3 Even though overall, Finsider achieved its planned targets in 1984, Italy's intra-Community trade position was declining particularly in flat products (1984: -2,1 million tonnes; 1986: -1,9 million tonnes; 1987: -2,3 million tonnes).

4.2.1 The plants to be closed in any event are:

Production capacities (in thousand tonnes)

	<u>Iron</u>	<u>Steel</u>	<u>Hot- rolled</u>	<u>Cold- rolled</u>
Bagnoli	2 350	2 700		
Campi (heavy plate)		350	400	
Turin (merchant bars, wire rod)		375	250	
Terni (concrete reinforcing bars)			300	
Sesto S. Giovanni (merchant bars, wire rod)			230	
Turin	-----	-----	-----	<u>708</u>
TOTAL	2 350	3 425	1 180	708

4.2.2 Plant covered by the ECSC Treaty to be sold to the private sector, or to be operated in conjunction with the latter, is as follows:

Production capacity (in thousand tonnes)

	<u>Iron</u>	<u>Steel</u>	<u>Hot- rolled</u>	<u>Cold- rolled</u>
Aosta (Cogne)(merchant bars,wire rod)		460	65	
Marghera (heavy and light sections)			130	
S. Giov. Valdarno (light sections)			150	
Sisma (heavy and light sections, wire rod)		240	230	
Trieste	590			
Lovere		145		
TOTAL	590	845	575	

4.2.3 The plan submitted by the Italian Government comprises a timetable for these closures and transfers starting from the end of 1988 to the end of 1990 (and even after 1990 in some instances, e.g. the Aosta plant).

4.3 Finsider's non-steel activities (e.g. Cementir (cement), Italmobiliare (engineering)) will be sold to third parties or to the IRI. The proceeds from the sale of these activities whose value is being or will be assessed by independent experts during the winding-up procedure, will be used to reduce Finsider's debts.

4.4 The Italian Government's plan will be accompanied by employment cuts of 19 915 persons from a total of 70 340 persons, i.e. a reduction of 28,3%.

4.5 Bagnoli - a special case

The Italian plan provides in principle for the closure of the upstream phase (iron and steel) at Bagnoli by no later than 1 July 1989. The wide strip mill would then be incorporated into ILVA's activities; production would vary, depending on the quantitative and qualitative development of demand, the utilization rate necessary to ensure profitability of the wide strip mill at Taranto and the probable market for its products⁴.

5. Financial aspects

The implementation of the Italian restructuring plan would entail a maximum financial contribution from the IRI of Lit 7 670 thousand million (4 950 million ECU), broken down as follows:

⁴ The number of employees at Bagnoli would then decrease from 3816 (1987) to 850.

5.1 Aid for financial restructuring

Total liabilities incurred by Finsider at 1.10.1988 amount to Lit 10 517 thousand million, corresponding to debts of Lit 10 030 thousand million and interest of Lit 487 thousand million (see point 5.1).

The liabilities will be absorbed as follows:

- transfers of steel and non-steel assets: Lit 1 500 thousand million;
- taking over by ILVA, in exchange for the steel assets transferred by Finsider, of part of the liabilities: Lit 2 085 thousand million;
- taking over by the State, either directly or through IRI, the public shareholder, of Lit 6 932 thousand million.

5.2 Contingency fund

A maximum of Lit 288 thousand million has been set aside in the event of transfers not reaching the expected selling prices.

5.3 Other operating aid

The aid of Lit 245 thousand million is intended to cover the deficit incurred by the provisional management of the installations to be closed or transferred in due course to the private sector (the installations described in point 4.2 and the Bagnoli plant). With the exception of Aosta, the plan provides for a timetable of closures and transfers starting at the end of 1988 and finishing end 1990.

5.4 Aid for closures

This concerns Lit 205 thousand million of aid for social purposes (contributions to the pension fund and the "Cassa Integrazione" (Wage Guarantee Fund)).

5.5 *The Commission Decision would thus concern a total of Lit 7 670 thousand million in State aids.*

The total appropriation includes several items which at this stage are only interim evaluations to be regarded as maximum amounts. The amounts finally authorized by the Commission will have to be justified and checked throughout the winding-up of Finsider and the start-up of ILVA.

IV. *Position of the Commission as regards the operation proposed in the plan presented by the Italian Government*

6 *The Italian initiative amounts to the granting of State aids to the Italian public steel industry*

6.1 *As the Commission already made clear in its arguments for the Article 88 ECSC procedure it opened against, on the one hand, the increase in Finsider's debts in 1987 and, on the other, the guarantee given to Finsider's creditors by the "voluntary winding-up" decision, it considers that the transfer of resources from IRI to Finsider must be regarded as comprising aid elements that are contrary to Article 4(c) of the ECSC Treaty, for the following reasons:*

- *the IRI would have been unable to take a decision of this importance without the encouragement and possibly the financial support of its shareholder, the State;*
- *carrying out its financial commitment of Lit 7 670 thousand million to Finsider (see point 5) would leave the IRI without any own capital (which amounts only to Lit 7 760 thousand million);*
- *since 1947, IRI has received a total of Lit 21 600 thousand million in capital contributions from the State; of that amount, Lit 13 840 thousand million (of which Lit 9 240 thousand million went to Finsider in 1982-86) were used to to offset the losses incurred by subsidiaries.*

- the IRI will not find on the capital markets the financing required to cover its commitments in view of both its considerable debts (70% of invested capital) and its results in the past, without the guarantee of the State which it enjoys.

In this context, IRI's commitment cannot be regarded as the "normal" behaviour of a private investor; the Italian State and IRI in fact acted jointly.

6.2 It is also clear that without the proposed financial restructuring, Finsider would be unable to continue in business. It would be condemned to bankruptcy, and its best assets would probably have to be broken up and sold rather than grouped together under ILVA, whose only means of purchasing them is through the combined intervention of the IRI and the State.

6.3 IRI's financial commitment, which will in the more or less distant future require at least partial financing by the State, thus at the very least comprises elements of State aid and is covered by the ban in Article 4(3) of the ECSC Treaty inasmuch as it does not meet any of the conditions for exemption under Commission Decision No 3484/85/ECSC.

The Commission therefore considers that where the plan to restructure the Italian public steel industry concerns the creation of ILVA, it should at least meet the criteria set by the Commission for its examination of the restructuring plans of various Community steel undertakings which received aid between 1981 and 1985. Experience has shown that the criteria can ensure a return to financial viability, provided that all the restructuring measures contained in the programmes are implemented in accordance with the timetable and conditions agreed on by the Member States and the undertakings.

The Commission will ensure that the aid it authorizes in its Decision does not benefit any steel subsidiaries not covered by the ECSC Treaty. Should such aid elements appear, they will be

examined in relation to and within the framework of the provisions and procedures of Articles 92 et seq. of the EEC Treaty. The Commission has already opened the Article 93(2) procedure against a recent subscription of new capital by Finsider in Dalmine, a pipe and tube manufacturer. The Commission will thus also ensure that the latter's liabilities are not affected by the financial transfers which form the subject of this communication.

7. Conditions the Commission intends to attach to its authorization of the State aids

In the view of the Commission, authorization of the aid in question should in any event be subject to the simultaneous fulfilment of three major conditions, which correspond to the position it adopted between 1981 and 1986. They consist of:

- checks that the measures envisaged in the plan are capable of making ILVA financially viable;
- limiting the amount of the aids to what is strictly necessary;
- a reciprocal concession, notably in the form of hot-rolled capacity cuts, commensurate with the amount of the financing in question.

7.1 Financial viability of ILVA

7.1.1 The Commission and the Italian Government jointly appointed a panel of independent experts to examine ILVA's viability prospects. Their assessment was based on criteria identical to those already imposed by the Commission during the previous restructuring of the Community steel industry, namely:

- the taking into account for the period 1988-1990 of a hypothetical trend in production costs and selling prices

- similar to that adopted at the time (i.e. a cost-price squeeze effect of -2.5% a year);
- a minimum depreciation level of 7% in order to guarantee the continuation or the replacement of the activities on which ILVA's viability is based;
 - a level of financial charges not lower than 4.5% of turnover, a level which all correctly managed firms should attain. In order to reduce state aid to the strict minimum, the Commission had already made the same demands on those firms granted additional aid in 1985 authorized under Commission Decision No 1018/85/ECSC⁵, as well as on Spanish and Portuguese firms.
 - a minimum return (1-1.5% of turnover) on own capital so that whether the capital stems from public or private sources, it produces a fair yield, ensuring that there is no discrimination between public and private undertakings;
 - realistic sales prospects in relation both to the estimates of the 1990 general steel objectives and to the 1986 and 1987 results. In this respect, unlike the Government plan which, in spite of an overall drop in sales of more than one million tonnes against 1986, anticipates a 300 000 tonne increase in sales by the Italian public steel industry on the Community market, the Commission has taken the same sales figures as for 1986 and 1987 into account for its viability assessment, as follows:

Sales taken into account in the calculation of ILVA's viability

	<u>thousand tonnes</u>		
	1986	1987	1990(1)
Total	11 032	10 790	9 664
of which			
Community	8 406	8 420	8 400
Non-community	2 626	2 370	1 264

5 OJ No L110, 23.4.1985.

(1) according to the Government plan, sales in 1990 will be:

	<u>thousand tonnes</u>
Total	10 003
Community	8 739
Non-Community	1 264

7.1.2 According to the experts' analysis, and provided that the restructuring follows the timetable and every possible rationalization is introduced, the gross operating result should rise from Lit 339 thousand million in 1987 to Lit 907 thousand million in 1990, i.e. 12,9% in relation to an estimated turnover of Lit 7 040 thousand million.

This result, taking into account the negative prices/costs squeeze effect of Lit 509 thousand million, would require an overall improvement of Lit 1 075 thousand million, obtained as follows:

- 22% through closures and the transfer of certain activities;
- 10% by modifying the volume and mix of certain products;
- 68% by improving internal management; over half the improvement will be obtained by reducing the workforce.

All the measures provided for in the plan have been checked from the standpoint of feasibility and their impact on the financial situation of the undertaking.

7.1.3 Overall, and in taking account of the conservative financial hypotheses which the Commission has used to assess viability, ILVA should achieve financial viability by 1990.

Nevertheless, ILVA will even then only form part of the group of Community steel producers with an average performance and, like these, will thus continue to be extremely vulnerable to

unfavourable market trends in a context where overcapacity in the Community could be lasting.

7.2 Limiting the aid to the bare minimum

7.2.1 Aid for financial restructuring (Lit 6 932 thousand million, see point 5.1)

The amount is determined by the Italian Government after deducting from Finsider's liabilities (Lit 10 030 thousand million).

- the income from the transfer of some of Finsider's assets (Lit 1 500 thousand million);
- the transfer to ILVA of part of Finsider's liabilities (Lit 2 085 thousand million).

The Commission will not be able to determine whether the residual amount is justified until it has verified:

- that the selling price of the assets are realistic, as they may exceed the estimated Lit 1 500 thousand million and thus further reduce the financing required;
- the liabilities transferred in relation to the transfers, which will also reduce Finsider's financial requirements;
- that ILVA will effectively be required to bear financial charges of 4.5%, which could mean that it takes over a larger proportion of Finsider's liabilities than the Lit 2 085 thousand million provided for in the Plan.

The Commission will also ensure that the aids, which are intended to repay the debts of Finsider, are paid to a blocked account which can be debited only for that purpose. The same will apply to the proceeds of the assets sold.

7.2.2 Operating aid (Lit 245 thousand million, see point 5.3)

The Commission considers that the aid should not exceed the amount needed to cover the requirements of the provisional management period, which must be shorter than envisaged in the Italian plan.

The transfers should be completed by the end of the first quarter of 1989, while plant which cannot be sold should be closed by 30 June 1989 at the latest. The Commission may, if met with well founded technical reasons, accord a short-term extension of the 31 March 1989 closure deadline.

As regards the special case of Aosta, provided that it is not sold or operated in association with other producers, keeping it in operation would require proof of its financial viability. Therefore, if no sale or association agreements are concluded by 30 June 1989, the Commission will examine the viability prospects of the plant which will have to be closed by 31.12.1989 if the prospects are unfavourable. Closures of steel plant already provided for in the plan should be carried out before the end of the first quarter of 1989, save as regards the liquid phase of Bagnoli which can be kept until 30 June 1989. The closures at the Campi plant (liquid phase and heavy plate mill), the liquid phase at Turin and the concrete reinforcing bars mill at the Terni plant should be completed, in accordance with the plan, before the end of 1988.

The utilization of this aid should therefore be extremely limited:

- on the one hand, because the results achieved by the installations to be closed or sold during the temporary management period should be better than expected owing to the improved situation in the steel market;

- on the other hand, as a result of tightening the timetable of closures and transfers, as required by the Commission.

7.2.3 Contingency appropriation (Lit 288 thousand million, see point 5.2)

This amount will be released only on a case by case basis, subject to justification.

7.3 Reductions in production capacities

Although it might seem that the number of closures is considerable (1.18 million tonnes hot-rolled capacity, i.e. in net terms 8% of capacity⁶), it nevertheless remains that in view of the amount of aid envisaged, the concessions could appear inadequate, especially in the light of the concessions demanded under Decisions 2320/81/ECSC and 1018/85/ECSC.

It should however be noted that the present restructuring follows extensive rationalization of the public steel industry (-23.6% of hot-rolled capacity) which entailed high "social costs" (32.5% of job cuts) especially in disadvantaged regions.

7.4 Other conditions

7.4.1 Anxious to secure the transparency not provided by the system of voluntary winding-up under which Finsider is currently being managed, and wishing to ensure, in ILVA's interest and in that of its competitors, that ILVA takes up its duties as quickly as possible, the Commission will also make its authorization conditional on ownership of the relevant industrial assets and share of Finsider's liabilities being transferred to the new company by 31st March 1989.

6 The plan submitted by the Italian authorities does not foresee any investment which could increase the production capacities.

7.4.2 As, furthermore, this is an exceptional procedure in favour of the public steel industry of a single Member State which has, moreover, already benefited as stated above from considerable state aid in the past, the Commission Decision will provide for the creation of a system for monitoring, in particular, of ILVA's behaviour as regards selling prices and the development of its financial position.

V. Conclusions

8. It is clear, therefore, that without State aid, the purpose of which is to eliminate loss-making activities in the Finsider Group and facilitate a regrouping of the most viable assets under a new company, ILVA, Finsider would be condemned to an untidy bankruptcy and the break-up of its assets.

In inviting the Council to approve the intention to adopt a Commission decision under Article 95(1) of the ECSC Treaty authorizing the financing provided for in the restructuring plan of the Italian public steel industry, subject to the limits and conditions described above, the Commission has sought to achieve a balance between the need for fair competition in the Community market and the social, regional and industrial needs now arising in Italy.

The Commission will also present this communication to the Consultative Committee with a view to obtaining its opinion in accordance with Article 95(1) of the ECSC Treaty.

The adoption of such a Decision by the Commission will enable it to close the Article 88 procedure.

The Commission will keep the Council informed of the progress made in the restructuring of the Italian public steel industry.