COMMISSION OF THE EUROPEAN COMMUNITIES

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Restructuring of the Spanish Steel Company SIDENOR

Communication from the Commission to the Council

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1. Introduction

1.1 On 12 April 1992 the Spanish Government notified the Commission of a plan to restructure the Spanish special steels company Sidenor, incorporating Acenor and Foarsa.

1.2 The plan involves Acenor and Foarsa ceasing their activities, which would be taken over by Sidenor, and comprises a number of industrial, commercial, financial and social measures which should allow Sidenor to achieve, by 1995, adequate operating results to achieve viability.

According to the Spanish Government, the total cost of the plan will be 89 billion pesetas (634 mecus). Since the financing of the plan includes aid elements that are incompatible with Article 4(c) of the ECSC Treaty and with the provisions of Commission Decision 3855/91/ECSC (the current Steel Aids Code) these measures can be authorised only if the Commission adopts a derogation decision under Article 95 of the ECSC Treaty, which requires the unanimous assent of the Council and consultation of the ECSC Consultative Committee.

2. Description of the company

2.1 Sidenor (which is owned jointly by the Spanish public bank BEX and the Spanish state holding company INI) was set up in early 1991 as a management company to co-ordinate the activities of Acenor (80% owned by BEX) and FOARSA (100% INI) with a view to their eventual merger.

2.2 The Group is presently active in three product areas: hot-rolled long products made of unalloyed and alloyed steel; forge and foundry products; and hot-rolled products made of stainless steel.

Acenor has five integrated plants (each comprising electric arc furnaces and rolling mills) situated at Basauri, Vitoria, Hernani, Llodio and Larrondo in the Basque. Foarsa comprises one plant at Reinosa only in the Cantabria. Five of the rolling mills (Basauri, Vitoria, Hernani, Llodio and Reinosa) are dedicated to unalloyed and alloyed long products, with stainless steel being manufactured only in Larrondo. Production of forge and foundry pieces is largely concentrated in Reinosa.

Acenor and Foarsa are in regions facing economic and social problems as follows:

Acenor has plants in Vizcaya, Alava and Guipúzcoa; all three are eligible for national regional aid under Article 92.3(c) and are Objective 2 regions. GDP per inhabitant (1986-1990) is 85.3, 104.9 and 92.1 respectively (Euro 12 = 100). Unemployment rates (1987-91) are 224.2, 211.5 and 225.6 respectively (Euro 12 = 100).

Foarsa is based in Cantabria whose GDP per inhabitant (1986-1990) is 69.9 (Euro 12 = 100) with an unemployment rate at 195.3 (Euro 12 = 100). Cantabria is eligible for national regional aid under Article 92.3(c) and is an Objective 2 region.

Declared current PMP capacity by plant is as follows:

	Basauri	Vitoria	Llodio	Hernani	Reinosa	Larrondo	Total
Liquid steel	348	489	277	228	200	95	1637
Hot rolled products	221	452	254	125	120	60	1232
Forgings and castings	15	-	-	-	40	-	55

In 1991, total Sidenor group sales amounted to 542,000 tons.

3. Financial Performance

3.1 During the period 1984-88 Acenor and Foarsa underwent restructuring measures from which they together benefited from state aids totalling over 70 billion pesetas (500 mecus).

3.2 Despite the previous restructurings and the 1991 reorganisation, the financial performance of the Group has continued to deteriorate. In 1990, the net losses of Acenor and Foarsa combined amounted to 11.1 billion pesetas (79.3 MECU). In 1991, reflecting the general downturn in the European special steels market, performance further worsened, with combined losses increasing to 17.8 billion pesetas (127.1 MECU) on a gross turnover of 45.2 billion pesetas (322.9 MECU).

3.3 Acenor's performance has been particularly bad (with losses in 1991 of 14 billion pesetas (100 MECU)). In July this year, following a number of complaints from the market about Acenor's pricing behaviour, the Commission decided to open the procedure provided for in Article 6(4) of the Steel Aids Code to investigate certain aid measures (in the form of the foregoing by BEX of capital and interest repayments on loans) granted to the company illegally, i.e. without prior notification to the Commission, allowing the company to continue to operate despite its serious financial difficulties.

4. <u>The Restructuring Plan</u>

4.1 In the light of the group's precarious financial position a restructuring plan was developed (with the assistance of independent management consultants) during 1991 based largely on the 1990 operating performance of the two companies. The plan proposes that Sidenor assume the activities of Acenor and Foarsa. Its main elements can be summarised as follows:

(a) the closure of Llodio and Hernani;
(b) a reduction of the labour force from 4725 in 1990 to 2,880 in 1995 (a 39% reduction);
(c) improved capacity utilisation and productivity at the remaining sites;
(d) industrial and commercial investments totalling approx. 30 billion pesetas (214m ecu) (in the light of changed market conditions since the plan was drafted, the company has subsequently decided to scale down these investments to approximately 20 billion pesetas (142.9 MECU));
(e) an increase in deliveries to 709,500 tons per annum by

1995.

Capacity

4.2 In terms of capacity, the plan envisages a total capacity reduction in liquid steel and hot-rolled products of 505,000 tons (from a current PMP as declared to the Commission of 1,637,000 tons) and 379,000 tons (from a current PMP of 1,232,000 tons) respectively through the closure of Llodio and Hernani, as shown in the table below:

	(in thousand tonnes)	
Plant	Liquid Steel	Hotrolled
Hernani	228	125
Llodio	277	254
Total	**505**	**379**

4.3 This represents a reduction in overall capacity of 31%. It should be noted that the industrial plan is already being implemented (the steel shops closed operations in late July this year; the rolling mill in Llodio was halted in mid-September and the rolling mill in Hernani is expected to cease in the first quarter of next year at the latest).

4.4 The site by site breakdown of the reduction in the workforce would be as follows:

Plant	1990	1995	Reduction
Basauri	870	713	157
Hernani	554	0	554
Larrondo	730	413	317
Llodio	564	0	564
Reinosa	1236	1081	155
Vitoria	771	673	98

5. Supplementary Measures Proposed

5.1 As in previous similar restructuring cases independent consultants were appointed (jointly by the Commission and the Spanish Government) to assess the viability of Sidenor's restructuring plan.

5.2 It remains the Commission's view, as in the past, 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 13.5% of turnover. The consultant's assessment was therefore based on criteria identical to those applied by the Commission during previous restructurings of the Community steel industry, namely:

- a price-cost squeeze of 2.5%;
- a minimuim depreciation level of 7% in order to guarantee a replacement of the activities on which Sidenor's viability is based at a price equal to that of competitors;
- a level of financial charges not lower than 4-5% of turnover (a level which was previously set to reduce state aid to the strict minimum);
- 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; and
- realistic sales forecasts, in view of the very difficult market conditions prevailing.

5.3 The consultants took into account the company's deteriorating performance in 1991 and concluded that on the basis of more conservative sales forecasts (581,500 tons in 1995, broken down as follows: special steel long products 508,600 tons, forge and foundry products 41,800 tons and stainless steel long products 31,000 tons) the plan should lead to Sidenor's financial viability by 1995 provided that certain additional measures are adopted:

- the disposal or closure of Larrondo;
- additional labour reductions by 1995 in order to further increase productivity and cater for possible down-turns in demand.

5.4 The closure of Larrondo would reduce liquid steel capacity by another 95,000 tons and hot rolling capacity by an additional 60,000 tons. It would also increase the job losses by another 413 people.

6. Financial Aspects

6.1 According to the Spanish authorities the maximum total cost of implementing the plan as proposed would be 89 billion pesetas (634 mecus), broken down as follows:

	bn ptas	MECU
Acenor and Foarsa Debt write-offs	44.6	318.6
Social costs of closures	24	171.4
Capitalisation of Sidenor	20.2	144.3

(i) Debt write-offs

These comprise:

For Acenor

(a) debts in the form of short and long term loans granted by BEX, which together with interest, amount to 28.32 billion pesetas (202 MECU);

(b) social security and tax payments totalling 14.44 billion pesetas (103 MECU); and

(c) outstanding liabilities to former employees totalling 4.477 billion pesetas (32 MECU).

For Foarsa

(a) Commercial debt of 2.411 billion pesetas (17.2 MECU).

These deficits total 49.648 billion pesetas (354.6 MECU), but would, according to the Spanish authorities, be partly offset by residual assets of 5.005 billion pesetas (35.8 MECU), reducing the overall deficit to 44.643 billion pesetas (319 MECU). These costs will be written off, met or otherwise underwritten by the Spanish government directly or indirectly through BEX and INI.

(ii) Labour Costs

The figure of 24 billion pesetas (171.4 MECU) represents the total costs of payments to workers made redundant or accepting early retirement as a result of the plan. These costs will be met by the shareholders of Sidenor (BEX and INI) with the support of the Spanish state.

(iii) Capitalisation of Sidenor

This would be new paid-in capital of 20.182 billion pesetas (144.3 MECU)to support the company's operations (including its investment programme, funding for which could be generated through cash flow) and takes account of a financing gap of 6 billion pesetas, identified by the independent consultants in their appraisal of the plan. According to the Spanish authorities, the intention is that this injection will come from the private sector but that at least initially this will be provided by the existing shareholders with support from the Spanish Government.

6.2 According to the Spanish authorities, they are entitled under the Steel Aids Code to grant aids totalling 48 803 billion pesetas (349 mecus), broken down as follows:

	bn ptas
Residual book value of closed installations	12.988 (92.8 MECU)
Social costs (ie 50% of total costs)	12 (85.7 MECU)
Capitalisation of BEX loan (plus interest) previously authorised	23.815 (170.1 MECU)

7. Position of the Commission

The Spanish plan amounts to state aid

7.1 The financial position of the Sidenor group is clearly very difficult and without the proposed restructuring it would be unable to continue in business. It is also clear that the restructuring requires financing by the State, either directly or indirectly through the public bank BEX and state holding company INI, who are the shareholders of the company.

Compatibility with Steel Aids Code

7.2 Under the Steel Aids Code only the following aids may be considered compatible with the orderly functioning of the common market: aid for research and development; aid for environmental protection; aid for the costs of payments to workers made redundant or accepting early retirement arising from the total or partial closure of steel plants; and aid to steel undertakings that permanently cease production. In addition, aid for investment under general regional aid schemes may also be allowed in Greece and Portugal (to small and medium-sized undertakings only), provided that there is no increase in the undertakings' production capacity; and in the former GDR provided that there is a reduction in the overall production capacity of that territory. All other aids for the steel industry are prohibited by Article 4(c) of the ECSC Treaty.

7.3 According to the Spanish authorities the maximum total social costs would be 24 billion pesetas, which would be borne by the State. Therefore the Commission considers this amount as state aid. Article 56 of the ECSC Treaty provides a possibility for refinancing part of this amount from the ECSC budget. The exact amount of the Community's contribution will only be determined after negotiation of a social plan with the Commission and will depend on factors such as age, length of service, retraining needs, etc. Under the current Steel Aids Code (Decision 3855/91/ECSC) and linked to closures up to 50% of the amount not covered under Article 56 ECSC may be deemed compatible by the Commission without requiring further Council approval. At this stage it is not possible to split the sum of 24 billion pesetas into the above categories or to separate out the amount which requires new aid approval under Article 95 ECSC. The full amount is included in the present proposal as a maximum amount of social aid to be approved.

7.4 As noted in paragraph 6.2 according to the Spanish authorities, the financial restructuring measures include the capitalisation of the outstanding balance of 18.290 billion pesetas, plus interest, on a BEX loan, which was previously approved under the terms of Protocol 10 to Spain's Treaty of Accession. According to the Spanish authorities, the foregoing by BEX of capital and interest repayments on this loan, which was the subject of the procedure opened under Article 6(4) of the Steel Aids Code, referred to in paragraph 3.2, is taken into account in this capitalisation.

The Commission is prepared to accept the capitalisation of the outstanding balance of the loan is not new aid, but cannot accept that the outstanding interest may also be capitalised as it never provided its approval for such an operation. The latter constitutes new aid to be included in the proposed Article 95 decision.

7.5 As regards the proposed aid for closures based on the residual book value of the closed installations, under Article 4.2(c) of the steel aids code such aids are limited to undertakings which permanently cease production, which is not the case here since Sidenor is controlled by the same undertakings that control Acenor and Foarsa (BEX and INI).

7.6 The Commission therefore considers that total maximum aid is <u>70.5 billion pesetas (505 mecus)</u>, broken down as follows:.

debt write-offs	26.3	(187.9 MECU)
social costs	24	(171.4 MECU)
capitalisation	20.2	(144.3 MECU)

<u>Viability of the Company</u>

7.6 As noted in paragraph 5.1, the Commission and the Spanish Government jointly appointed an independent expert to examine Sidenor's viability prospects. All the measures provided for in the plan have been assessed from a commercial, industrial and financial viewpoint and the Commission is prepared to accept the consultant's conclusions that, provided the restructuring plan is strictly followed, and the additional measures proposed adopted, the company should return to viability in 1995. According to the consultant's analysis the company should on an estimated turnover of 49.3 billion pesetas (352.1 MECU) return to positive operating results, with a gross operating return of 13% [with depreciation of 6% over sales and financial charges of 6.3%].

8. <u>Conditions the Commission intends to attach to its authorisation of State Aids</u>

8.1 The Commission takes the view that the amount of aid proposed is the minimum necessary in order to ensure the viability of the plan. It also recognises that the proposed reductions of 31% in liquid steel and hot-rolled capacities are substantial. There are no reliable statistical data relating to the actual EC special steels market, but it is evident that the proposed cuts will contribute towards the reduction of over-capacity in the sector.

8.2 It is important that these capacity reductions should be of a genuine and irreversible nature. In order to ensure this it is proposed that the Commission's Decision should provide that there should be no increase in the company's overall capacity in hot rolled products during the restructuring period (up until end 1995) without the Commission's prior approval.

8.3 Furthermore, the Commission considers that it should make its approval conditional on the sale of Larrondo to the private sector or its closure as recommended by the consultant. The Commission proposes that the deadline for disposal or closure should be 30 June 1993. Other plants closed under the plan cannot be sold for subsequent use in Europe. Provision will also need to be made for additional workforce reductions as may be necessary in order to ensure the future viability of the company. Precise details on this aspect will be worked out with the Commission.

8.4 Furthermore, as in similar cases in the past, the Commission Decision will provide for regular monitoring reports to check on satisfactory implementation of the plan as well as on the company's selling prices (particularly in view of the previous complaints from the market about Acenor's aggressive pricing) and the development of its financial position.

9. <u>Conclusions</u>

9.1 It is clear that the proposed restructuring of the Sidenor group, without which it would be unable to continue to operate, involves state aids which are incompatible with the Steel Aids Code and are therefore normally prohibited by Article 4(c) of the ECSC Treaty. In inviting the Council to approve the intention to adopt a Commission Decision under Article 95(1) of the ECSC Treaty authorising the aids provided for in Sidenor's restructuring plan, subject to the limits and conditions described above, the Commission's objective is to achieve a balance between the Spanish Government's wish to put the company on a secure and viable footing, taking into account also the social and regional needs of the Basque region, and the need for aid approved not to adversely affect trading conditions within the Community special steels industry to an extent contrary to the common interest.

9.2 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.

9.3 The adoption of the Commission's Decision should enable it to close the procedure opened under Article 6(4) of the Steel Aids Code in respect of aids already being granted to Acenor (see paragraph 3.3 above).

9.4 The Commission undertakes to keep the Member States informed on a regular basis of the progress of the restructuring plan's implementation.