II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 26 July 1988
on aids granted by the Italian Government to ENI-Lanerossi

(Only the Italian text is authentic)

(89/43/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having given notice to the parties concerned to submit their comments as provided for in the said Article 93, and having regard to those comments,

Whereas :

I.

In 1962, Lanerossi SpA was taken over by the State holding company Ente Nazionale Idrocarburi (ENI) both for the purpose of creating a vertically fully integrated textile group and to resolve the economic and financial problems of a number of private textile and clothing companies which for this purpose were in turn taken over by Lanerossi.

Over the years, and by way of considerable restructuring efforts, it was possible to return some of these subsidiaries to viability so that they could be transferred to the private sector again.

Certain other subsidiaries, however, remained loss-making and continued to receive financial assistance in the form of loss compensations through the Italian Government in order to remain in business. This, particularly, was the case for four subsidiaries of Lanerossi SpA in the subsector of men's outer wear : Lanerossi Confezioni (Arezzo, Macerata, Orvieto), Intesa (Maratea, Nocera, Gagliano), Confezioni di Filottrano (Ancona) and Confezioni Monti (Pescara). Between 1974 and 1979, the yearly losses of these firms grew from Lit 2 billion to Lit 39 billion and, in 1979, the Commission received an official complaint from the European Association of the Clothing Industry (AEIH) and later from other textile industry federations which considered that the continuing compensation of operating losses of these subsidiaries would considerably distort competition in the Community.

On the basis of a detailed examination of the situation and development of the State-owned manufacturers of men's outer wear and taking into account the information provided by the Italian Government in this respect, the Commission took the view that the interventions in favour of these enterprises had to be considered as aids within the meaning of Article 92 (1) of the EEC Treaty. In its letter of 26 June 1980, it informed the Italian Government that these measures could only be granted an exemption from the incompatibility rule of Article 92 (1) provided that the assistance was granted for a limited period and under the condition that the restructuring programme as presented to the Commission was carried out for the purpose of reducing the capacities of the companies concerned and returning them to viability and to financial self-support in the short term.

After having followed the subsequent development of the State-owned manufacturers of men's outer wear very closely, the Commission, in a letter to the Italian Government dated 20 May 1983, considered that as regards a fifth subsidiary of Lanerossi in this sector, Lebole SpA, the financial assistance which had been given in order to compensate for its losses was matched by restructuring efforts already implemented and to be implemented shortly afterwards which were of such a kind as to exclude any simple rescue operation or operating aid. The Commission, therefore, concluded that

this financial assistance could benefit from the derogation of Article 92 (3) (c) of the EEC Treaty and thus could be regarded as being compatible with the common market. On the basis of a monitoring of progress on the implementation of the restructuring programme of this firm after 31 December 1983, the Commission was able to confirm its earlier position and to close the file on Lebor SpA definitively.

As regards the four other abovementioned subsidiaries of ENI/Lanerossi, the economic and financial results achieved by the end of 1982 showed that the restructuring efforts of the past years had not been successful and it was evident that these factories would continue to suffer from serious structural difficulties in spite of constant support through public funds. Losses between 1980 and 1982 had reached well over Lit 150 billion. Equally, in the restructuring programme for the years 1983 to 1986, which had been made known to the Commission by the Italian Government, these four companies were expected to continue to rely heavily on State intervention and public funds in order to compensate for their losses.

In its letter of 20 May 1983, already referred to, the Commission stated that in a business marked by very strong competition and overcapacity at Community level, depressed prices and heavy intra-Community trade, the artificial maintenance through public financial assistance of even relatively small amounts of production and exports is likely to increase the difficulties of undertakings which are not in receipt of State aid. The Commission, having taken into account the social and regional importance of these factories, raised no objections to the aids granted until the end of 1982, but expressed very serious doubts as to whether financial assistance from public funds in order to cover operating deficits of these subsidiaries could in future be regarded as compatible with the orderly functioning of the common market. The Commission informed the Italian Government that if there were to be future interventions of this kind, it would be obliged to take appropriate measures. It also reminded the Italian Government that under Article 93 (3) of the EEC Treaty there exists an obligation on Member States to inform the Commission, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. It requested the Italian Government to indicate within two weeks of receipt of the letter of 20 May 1983 its intentions in this respect.

By telex of 24 June 1983, the Italian Government informed the Commission that it would notify any future interventions in favour of these four men's outer wear factories pursuant to Article 93 (3) of the EEC Treaty.

Having received information according to which these factories continued to suffer considerable losses, the Commission, by letter of 22 July 1983, reminded the Italian Government of its letter of 20 May of that year and repeated that no further aids in favour of these subsidiaries of ENI/Lanerossi could, in view of their history and the situation the market concerned was in, be regarded as being compatible with the common market.

By letter of 2 November 1983, the Italian Government confirmed that no State aids were envisaged in favour of these factories which were regarded by the ENI/Lanerossi management as unrestructurable, so that the abovementioned restructuring programme for the years 1983 to 1986 would not be executed.

II.

Subsequently, press reports suggested that, despite the Italian Government's confirmation, these factories remained in business, continued to suffer losses and, to avoid bankruptcy, would probably have to receive State aids again. Therefore, the Commission repeatedly requested the Italian Government to submit information as regards the real situation in this respect.

By letter of 30 August 1984, the Italian Government transmitted to the Commission a summary of a new restructuring programme for the men's outer wear factories of ENI/Lanerossi. From this document it appeared that the management of ENI/Lanerossi continued to consider these factories not to be restructurable. However, they continued to stay in business despite their operating deficit, which in the operating year 1983 alone reached Lit 78 billion. By way of reduction and subsequent increase of capital these losses had been compensated through public finance. From the summary of the new restructuring programme it became obvious that also in future years loss compensation would be required as the factories were not expected to break even quickly.

It also appeared that the abovementioned compensation had taken place after the end of 1982, which had been fixed by the Italian Government as the definite end of the restructuring efforts for these factories.

Following a scrutiny of the aid granted in the form of loss compensation, the Commission considered that it had not been notified to it beforehand and that it was illegal as the Italian Government had failed to fulfil its obligations under Article 93 (3) of the EEC Treaty. The Commission also took the view that the intervention in favour of these four subsidiaries of ENI/Lanerossi was to be considered as rescue aid in view of the factories' financial and economic record and situation. As it is the Commission's policy that rescue aids pending a restructuring plan can only be

granted for a short period and in the form of credit or loans at the market rate, of which the Member States had been informed by letter of 24 January 1979, the aids in question did not meet the conditions set out by the Commission.

The Commission also considered that the aids had been granted in contravention of its decision not to assist these factories as from the end of 1982 onwards, as communicated to the Italian Government by letters of 20 May and 22 July 1983 and repeated and reconfirmed by letter of 7 December 1983.

The Commission took the view that the aids, already granted and possibly envisaged, would not promote a development which from the Community point of view would be adequate to counteract their trade-distorting effects, particularly in a situation where the sector concerned is faced with serious problems of structural overcapacity, depressed prices and a high level of intra-Community trade, which is why it is considered as one of the most sensitive subsectors of the whole textile and clothing industry. Thus, the Commission considered that the aids could not be regarded as compatible with the common market and could not benefit from one of the derogations provided for by Article 92 (3) of the EEC Treaty.

Consequently, the Commission initiated the procedure provided for in the first subparagraph of Article 93 (2) of the EEC Treaty.

By letter of 19 December 1984, it gave the Italian Government notice to submit its comments. The other Member States were informed on 12 February 1985 and interested parties on 23 February 1985.

III.

Having received a reminder from the Commission dated 26 February 1985 and having requested and obtained a new deadline for submitting its comments under the procedure thus initiated, the Italian Government, by letter of 28 May 1985, pointed out that a tendency towards reduced losses of the factories in question can be observed. Equally, the workforce is being reduced. The fact that the factories were taken over from the private sector at a time when they were practically bankrupt implied that restructuring efforts cannot succeed in a short period. Having realized now that these factories are probably unrestructurable, there is a need to reconvert them to other activities while at the same time ensuring that Lanerossi's activities as such are not endangered. To reach satisfactory results, it must be accepted, therefore, that this will take a longer period of time. The Commission's request to stop all interventions in favour of these companies immediately would thus destroy all past efforts and would have serious social consequences.

In its letter of 28 May 1985, the Italian Government also took the view that the State interventions in the form of gifts of capital in favour of ENI only partially went to Lanerossi so that they do not constitute State aid altogether. Furthermore, in view of Italian legislation, losses have to be compensated immediately by shareholders in order to avoid bankruptcy which is why a notification pursuant to Article 93 (3) of the EEC Treaty was impossible. Finally, the Italian Government referred to the market and export shares of the factories which had gone down between 1980 and 1983 so that aids in favour of these companies would have no effect on trade and competition.

During a bilateral meeting held on 21 June 1985, the Italian Government announced additional information on the new programme to restructure certain parts of these factories and to reconvert others in order to enable the Commission to examine the restructuring/reconversion programme as a whole. It was also indicated that this programme would shortly lead to a definite solution so that not only the current efforts but also their final results could be examined by the Commission shortly.

Not having received this data, the Commission reminded the Italian Government by telex of 7 August 1985. By telex dated 25 September 1985 and again by letter of 12 December 1985, the Italian Government successively requested and obtained additional deadlines.

By letter dated 5 February 1986, it transmitted a partial reply concerning the progress of the restructuring and reconversion programme, announcing that a definite solution would be found in the near future on the basis of which the Commission should then examine the case.

During a bilateral meeting held on 12 June 1986, the Italian authorities confirmed a figure of Lit 78 billion for the loss compensation in 1983 and figures of Lit 56,8 billion and Lit 42,2 billion for the years 1984 and 1985 respectively. They also confirmed that the factories in question would either be transferred to the private sector or reconverted to other activities or both. They underlined, however, that a definite solution would take time.

The Commission insisted that the loss compensations of 1984 and 1985 had again been undertaken without prior notification and that, in order to examine the aid case in full, certain information was still missing.

Again, a partial reply was sent by letter dated 8 September 1986 and, following a reminder of 17 September 1986 from the Commission, a bilateral meeting held on 7 November 1986 clarified certain other information and data. At the same time, the Italian authorities insisted that a definite solution would soon be found and that they would communicate the details to the Commission in good time.

During a bilateral meeting held on 11 September 1987, it appeared that a transfer of the men's outer wear factories to the private sector and a reconversion to other activities was under way but had still not been finalized. Confirmation of this information and certain details of the transfers already executed were communicated by the Italian Government in a letter dated 15 December 1987.

During a further meeting held on 26 January 1988, it appeared that by March 1988 ENI/Lanerossi would transfer all remaining factories to the private sector thus terminating State participation in the sector of men's outer wear. The economic result of the various transfers would be that of the original 3 563 employees in 1983, 38 % would have taken early retirement, 25 % would have been transferred to the private men's outer wear sector (civil), 20 % to the private men's outer wear sector (military) and 17 % transferred to other subsectors of the textile and clothing industry and other industrial branches, e. g. shoes. Production output would be transferred in the same way. The Italian Government argued that these reconversions, by reducing the pressure in the men's outer wear sector, benefited the Community textile and clothing industry as a whole.

The transfer of machinery, equipment and stocks took place on market terms and on the basis of an evaluation carried out by an international bank.

This information was confirmed by telex of 5 March and letter of 22 July 1988. Also, the Italian Government informed the Commission that loss compensation amounted to Lit 45,9 billion in 1986 and, finally, to Lit 37,5 billion in 1987.

Three other Member States and three parties concerned other than Member States commented under this procedure.

IV.

The interventions by the Italian State in favour of ENI/Lanerossi which were intended to cover operating losses suffered by its men's outer wear subsidiaries between 1983 and 1987 and amounted to Lit 260,4 billion took the form of capital donations explicitly and specifically intended to serve the above purpose. Where it is apparent that a public authority which injects capital into a company is not merely providing such equity capital under normal market economy conditions, the case has to be assessed in the light of Article 92 of the EEC Treaty.

Here, the interventions in the form of loss compensation granted to the men's outer wear subsidiaries of ENI/Lanerossi prevented forces at work in the market economy from having their normal consequences, namely the disappearance of these uncompetitive factories, kept them in business artificially over a long period of time and encumbered the structure of the Community men's outer wear industry facing severe adaptation difficulties resulting from structural overcapacity, depressed prices and fierce competition from both within and outside the Community.

Loss compensations were granted in circumstances that would not be acceptable to a private investor operating under normal market economy conditions, as in the present case the financial and economic position of these factories, particularly in view of the duration and volume of their losses, was such that a normal return in dividends or capital gains could not be expected for the capital invested. Furthermore, the Italian Government and ENI/Lanerossi had taken the view that the factories were unrestructurable so that they would have to continue to suffer operating losses unless closed or reconverted.

It should also be noted in this respect that the Court of Justice clarified the application of Article 92 (1) of the EEC Treaty in respect of public holdings (see judgment of 14 November 1984 in Case 323/82, *Intermills,* and judgment of 10 July 1986 in Cases 234/84, *Meura,* and 40/85 *Boch).* In order to determine whether a contribution to capital is State aid, the Court held that it is necessary to see whether the company in question could have obtained the finance on the private capital market. Where the evidence suggests that the beneficiary could not have survived without public funds because it could not have raised the capital required on the open market from a private investor, it is right to conclude that the payment constitutes State aid.

This position was also made clear in the Commission's letter to Member States of 17 September 1984.

In the case in question here and on the basis of the facts outlined above it is unlikely that the factories concerned could have obtained sufficient capital to ensure their survival on the private capital market, as no private company or investor, basing its or his decision on the foreseeable possibility of profit, and disregarding any social considerations or considerations of regional or sectoral policy, would have made capital subscriptions to cover the operating losses over such a long time. In consequence, the interventions of Lit 260,4 billion constitute State aid within the meaning of Article 92 (1) of the EEC Treaty.

V

Therefore, these aids had to be notified to the Commission as provided for by Article 93 (3) of the EEC Treaty. Since the Italian Government failed to notify the aids in question in this case in advance, the Commission was unable to state its views on the measures before they were implemented. Thus, the aids are illegal in relation to Community law from the time that they came into operation. The situation produced by this failure to fulfil obligations is particularly serious since the aids have already been paid to the recipient. Furthermore, as confirmed by the Italian Government a large part of the total aid was granted after the Commission had initiated the formal examination procedure under Article 93 (2) of the EEC Treaty on 5 December 1984.

In this respect it has to be recalled that — in view of the imperative character of the rules of procedure as laid down in Article 93 (3) of the EEC Treaty which also are of importance as regards public policy, the direct effect of which the Court of Justice has recognized in its ruling of 19 June 1973 in Case 77/72 — the illegality of the aids at issue here cannot be remedied *a posteriori*.

The illegal character of all aids at issue here results from the failure to respect the rules of procedure as laid down in Article 93 (3) of the EEC Treaty. Moreover, in the case of aids which are incompatible with the common market, the Commission, making use of a possibility given to it by the Court of Justice in its judgment of 12 July 1973 in Case 70/72, confirmed in the judgment of 24 February 1987 in Case 310/85, can require Member States to recover from recipients aid granted illegally.

VI.

Here, the aids in question are incompatible with the common market under Article 92 of the EEC Treaty.

In the textile and clothing industry and particularly in the subsector of men's outer wear there is trade between Member States, as sufficiently documented by statistical evidence, and competition is very keen. Intra-Community trade in this product group, which comprises the Multifibre categories 14 A + B, woven coated and other woven coats for men, category 16, woven suits for men, and category 17, woven jackets for men, represented 19,3 % of production in 1983 and 29,1 % in 1986. Italian production in these categories represents 38,6 % of total Community output and exports of Italian men's outer wear to other Member States increased by 32 % between 1983 and 1986.

The four factories in question here represented in 1983 in terms of production output 2,5 % of the Italian industry in this sector. In terms of labour force, however, they had a share of 11 %. With 3 563 employees in 1983, these subsidiaries were among the most important men's outer wear manufacturers in the Community as, in this sector throughout the Community, the small firm is typical and the large firm rare. Even large firms often have modest sized plants. Moreover, below the firms considered industrial (20 or more employees), there were and are large numbers of workshops. ENI/Lanerossi's exports amounted in 1983 to 14 % their total men's outer wear production, thus the group participated actively in intra-Community trade in the sector at issue here. Since 1983 and by way of closure or reconversion to other subsectors of the textile and clothing industry or other branches of industry the abovementioned shares were reduced. However, certain sites, representing approximately 45 % of the 1983 workforce, were sold to independent private companies continuing to produce men's outer wear (civil and military) and, moreover, the reconversion of other production facilities, representing some 17 % of the 1983 workforce and production, led to increases of production in sectors which are equally characterized by keen competition and high and constantly increasing levels of trade between Member States, like jeans, women's wear, pyjamas, and shoes and leather.

The aids at issue here distorted competition because they calculably improved the financial position of ENI/Lanerossi and its four subsidiaries in question, thereby giving them a competitive advantage over other manufacturers, all suffering from stagnation of demand, depressed prices and overcapacity. Moreover, the aids which have been granted to cover the operating losses of these factories — amounting approximately to their turnover in the years 1983 to 1987 — restored the finances of firms which under normal circumstances would have disappeared in 1983 at the latest. Financial assistance amounting to Lit 260,4 billion in the form of loss compensation

restored the factories' finances and facilitated the reconversion and takeovers by such a margin as to give ENI/Lanerossi a very considerable advantage over its unaided competitors.

When State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid. In this case, the aids which enabled the four subsidiaries of ENI/Lanerossi to survive after 1982 and, secondly, facilitated the reconversion and selling-off of certain production sites, all costs which ENI/Lanerossi would normally have to bear itself, are liable to affect trade and distort or threaten to distort competition between Member States by favouring this group within the meaning of Article 92 (1) of the EEC Treaty.

Article 92 (1) of the EEC Treaty lays down the principle that aid having the features there described is incompatible with the common market.

The exceptions from the principle of incompatibility as set out in Article 92 (2) are not applicable in this case because of the character of the aids which, furthermore, were not intended for such purposes.

Article 92 (3) sets out which aids may be considered to be compatible with the common market. Compatibility with the Treaty must be determined in the context of the Community and not of a single Member State. In order to safeguard the proper functioning of the common market and taking into account the principles of Article 3 (f) of the Treaty, the exceptions from the principle of Article 92 (1) as set out in Article 92 (3) must be construed narrowly when an aid scheme or any individual aid award is scrutinized.

In particular, they may be applied only when the Commission is satisfied that the free play of market forces alone, without aid, would not induce the prospective aid recipient to adopt a course of action contributing to the attainment of one of the said objectives.

To apply the exceptions to cases not contributing to one of the objectives set out in Article 92 (3) or where an aid is not necessary to that end would be to give unfair advantages to certain industries or undertakings, the financial positions of which would merely be bolstered, and would allow trading conditions between Member States to be affected and competition to be distorted without any justification on grounds of Community interest as set out in Article 92 (3).

The Italian Government has been unable to give, or the Commission to discover, any justification for a finding that the aids fall within one of the categories of exceptions in Article 92 (3).

VII.

The four subsidiaries of ENI/Lanerossi concerned here were part of the men's outer wear industry which is a subsector of the textile and clothing industry. Also, the group ENI/Lanerossi had other important interests in this branch of industry during the period in question. Therefore, the financial assistance granted to ENI between 1983 and 1987 and amounting to Lit 260,4 billion is in full subject to the conditions for aids to the textile and clothing industry, as defined in the Community guidelines for aid to this sector of 1971 and 1977, as communicated to the Member States by letters of 30 July 1971 and 4 February 1977.

These guidelines contain a number of criteria worked out by the Commission with the aid of national experts in order to guide the Governments of the Member States on interventions they may possibly wish to make in this sector. In the 1971 guidelines the Commission points out that aids in the textile and clothing sector, which is marked by a very high degree of competition at Community level, involve a risk of causing distortion of competition which is unacceptable to competitors who do not benefit from such measures. Aids, which generally have very marked repercussions in this sector of industry, may under these guidelines be justified if they improve the structure of the textile industry. Such structural aids must be understood, according to the guidelines, to refer to aids to textile undertakings intended, *inter alia*, to facilitate the elimination of surplus capacity in the branches or sub-branches where it exists and to encourage the conversion of marginal activities to activities other than those of the textile sector. Aids of this nature must, however, meet certain conditions specified in the guidelines of 1971.

Subsequent developments, in particular several aid schemes and individual aid awards introduced because of the pressure of the economic situation and employment considerations and found to conflict with the Community interest in a number of respects, confirmed the Commission's concern so that it specified the guidelines in 1977.

The Community textile and clothing industry has undergone an extremely rapid process of change over the last 10 years. Production has declined under the pressure of outside competition both on traditional export markets and on the Community market. One million jobs, representing nearly 40 % of total employment in these industries, were lost between 1975 and 1985. Both the severity and length of the crisis have forced undertakings in this sector to make great efforts to restructure and to modernize their production plants. As a result, the industry has been able to adapt and to reestablish progressively its competitiveness and profitability. The important role played by the Community guidelines for aid to this sector in restoring a certain balance and in maintaining or reestablishing a true market economy has been widely recognized. As, however, the industry remains very vulnerable, not least because it continues to be subject to extremely strong international competition, the Commission takes the view that uncoordinated State intervention would conflict with the Community interest, particularly by putting at serious risk the past and, indeed, present efforts undertaken by the Community textile and clothing producers to adapt to changing market conditions. Therefore, the Commission continues to attach the greatest value to the taking into account by Member States of the abovementioned guidelines.

The aids in issue here do not meet several of the conditions set out in the guidelines : Firstly, these guidelines contain no provision for the granting of aids for the purpose of maintaining a company in business. On the contrary, in textiles the rescue of ailing companies has always been rightly regarded as not bringing about any lasting improvement in the industry either at national or at Community level, but would instead affect conditions of competition in the common market without facilitating an improvement in the industry's competitive position which is a prerequisite for its recovery and success on the international textile market.

Secondly, the guidelines require aids to textile and clothing companies to apply for a short period only. This condition is not fulfilled in the case at issue here as, after the period from 1974 to 1982 for which the Commission had approved aids in view of several restructuring programmes to be executed in order to return the men's outer wear factories to viability and financial self-support (which proved to be unsuccessful), the Italian Government continued to grant financial assistance during a further five years, that is in the period 1983 to 1987.

Thirdly, under the guidelines the aim of aids must be to provide the beneficiary in the short term with a level of competitiveness sufficient to ensure success on the Community textile and clothing market. The four men's outer wear factories at issue here, however, after having received very substantial aids before 1983, continued to suffer great losses, which during most of the following years reached the level of their turnover, so that this condition equally is not fulfilled. It should be added in this respect that at least from 1984 onwards it was obvious to all parties involved that the factories were unrestructurable which is why the objective of aids intended to improve the structure of the industry by way of adaptation and restructuring could no longer be attained.

Fourthly, the aids granted in this case were not earmarked for specific operations but were intended and used in general to improve the financial situation of the factories so that, from the beginning in 1983, it was highly unlikely that the aids could serve any other purpose but artificially maintaining the production in question.

In such a situation a further condition set in the guidelines also is not met. As there is no direct or, indeed, indirect link between the aids and individual operations, an appraisal of the impact of the aids on benefiting operations is not possible.

Finally, the guidelines require that aids must not affect competition and trade more than is absolutely necessary. In this respect it has to be pointed out that in 1983 the four men's outer wear subsidiaries of ENI/Lanerossi exported 14,3 % of their production and received loss compensations of Lit 78 billion in a situation were their 1983 turnover was Lit 78,2 billion. In subsequent years, turnover fell because of closures, selling and reconversion of sites but losses remained at levels close to turnover to reach Lit 37,5 billion in 1987 when turnover stood at Lit 36,8 billion in a situation where Community production in the product groups concerned here fell by 15,3 % between 1983 and 1986 while the share of this production traded within the Community increased by 27,7 % to reach a share of 29,1 %. It is obvious that the maintenance of the uncompetitive production of the four men's outer wear subsidiaries of ENI/Lanerossi, a considerable part of which was exported to other Member States, must have adversely affected competition and trading conditions. This is particularly so because ENI/Lanerossi's men's outer wear subsidiaries with 3 563 employees in 1983 were among the most important manufacturers of such products in the Community. In a situation where the industry concerned is highly splintered and where there are many hundreds of small competitors, aids in favour of one of the largest manufacturers in the sector have particularly adverse effects on trade and competition.

In view of the foregoing considerations it is concluded that all the aids in question here were granted in contravention of the Community guidelines on aid to the textile and clothing industry.

VIII.

All the aids in question, that is Lit 260,4 billion, were primarily paid in order to restore the finances, of the four men's outer wear factories. It has to be pointed out that the Commission had informed Member States by letter of 24 January 1979 of the conditions under which rescue aids could be regarded as compatible with the common market. Rescue aids, which may merely be granted to keep a firm in business while the causes of its difficulties are discovered and a remedy is worked out, must observe, *inter alia,* the following conditions :

— They must consist of cash aid in the form of loan guarantees or loans bearing normal commercial interest rates.

The aids of Lit 260,4 billion do not meet this condition.

— They must be paid only for the time needed, generally not exceeding six months, to draw up the necessary and feasible recovery measures.

In this case, the rescue aids of the years 1983 to 1987 which took the form of successive loss compensations by way of injecting new capital were definitely not granted for a short period and neither a duration nor a selling price was fixed in advance nor have they been recovered. The aids were granted without any conditions to be met by the subsidiaries and their only aim was to keep the ailing companies in business.

Also, the aids were granted without the necessary and feasible recovery measures being drawn up. Several restructuring plans elaborated to this end were given up shortly after having been implemented and, in 1984, both the Italian Government and ENI/Lanerossi acknowledged the fact that the four subsidiaries were unrestructurable.

— They must not have any adverse effects on the industrial situation in other Member States.

In this case, however, the subsidiaries in question participated actively in intra-Community trade, as documented above. Also, as from the early 1970s this subsector of the textile and clothing industry has always been considered to be in a very serious and difficult situation because of fierce competition both from within and outside the Community, reduced production, depressed prices and an uncontested and persistent overcapacity at Community level currently still estimated at some 20 to 25 %.

In its reply to these challenges, the Community men's outer wear industry, which primarily consists of small to medium-sized companies to be numbered by the hundreds, has undertaken extensive efforts to adjust, to modernize plants and equipment and to increase efficiency. Firms which could not be restructured went out or business as documented by the large number of factory closures and reduction in employment in this sector since 1975. Taking the Community as a whole, it can be observed that the clothing industry lost nearly 3 000 companies or 28 % and the workforce was reduced by 398 000 or 36,6 %, both between 1975 and 1985. In Italy, the number of clothing companies was reduced by approximately 600 or 32 %, while the workforce in this sector fell by 83 000 or 42 %.

In such circumstances the industrial situation in other Member States has been adversely affected by the aids in question here. Even if in terms of production output the four subsidiaries of ENI/Lanerossi only represented 2,5 % of the Italian men's outer wear industry, the aids of Lit 260,4 billion contained an advantage amounting approximately to the factories' turnover of the years 1983 to 1987 and thus saved the factories from bankruptcy and considerably strengthened their position compared to their competitors in intra-Community trade. Consequently, the latter and, indeed, the whole industrial situation of this sector in other Member States were adversely affected.

— They must be notified to the Commission in advance in significant individual cases.

The case in question here is significant, particularly in view of the size of the aids and because of the absolute and relative size of ENI/Lanerossi and its four men's outer wear subsidiaries, so that it must be concluded that the Italian Government did not fulfil its obligation to notify the aids in sufficient time to enable the Commission to submit its comments and, if necessary, initiate in respect of them the administrative procedure provided for in Article 93 (2) of the EEC Treaty. It should be recalled that a considerable part of the aids was even paid after the opening of such a procedure on 5 December 1984. The failure to notify is particularly serious since the Italian Government, by telex of 24 June 1983, had informed the Commission that it would notify any future interventions in favour of these four men's outer wear factories in good time and pursuant to Article 93 (3) of the EEC Treaty.

It is in view of this confirmation that the Italian Government's argument, advanced under the procedure in its letter of 28 May 1985, that it could not notify the aids in advance because of Italian legislation must be rejected. Such legislation cannot be used to defend State action which is incompatible with the Treaty.

Moreover, the losses of the factories had been accumulated during the course of the various operating years, so that an *a priori* notification of loss compensation would, in any case, have been possible, even if it did not specify the exact amounts involved.

Finally, it is clear from the judgements of the Court of Justice in Cases 234/84 and 40/85, already referred to above, that rescue aid will not qualify for one of the derogations under Article 92 where it does not help to restore a firm to health, that is to say where the firm cannot be expected to be operating on a viable basis without further assistance in a reasonable time, particularly where there is excess production capacity in the industry concerned in the Community. In this case it was clear from 1983 onwards, and after considerable aids had been granted for the purpose of covering losses during the period 1974 to 1982, that the four men's outer wear subsidiaries of ENI/Lanerossi would continue to rely heavily on State interventions and public funds. This expectation was borne out by the events up to March 1988 when it was announced that State participation in this sector would now finally be terminated.

In view of the above arguments, it has to be concluded that the financial injections in the form of loss compensations did not meet several conditions linked to rescue aids as set out in the Commission's letter to Member States of 24 January 1979 and as defined by the Court of Justice in the abovementioned judgments.

IX.

Between 1983 and March 1988, ENI transferred most of its Lanerossi men's outer wear factories to the private sector. Of the 3 563 employees in 1983, 38 % went into early retirement and the rest was transferred to independent private companies together with the production sites in question. According to information received from the Italian Government, these sites were sold on the basis of an economic and financial evaluation carried out by an international bank.

By way of the abovementioned transfers, ENI/Lanerossi has terminated its participation in the men's outer wear sector.

As a result of these transfers, 45 % of the original (1983) production capacity remained in men's outer wear (civil and military) and 17 % was reconverted to other subsectors of the textile and clothing industry and to other branches of industry.

Under the procedure, the Italian Government argued that these reconversions considerably reduced the pressure in the men's outer wear sector and thus benefited the Community textile and clothing industry. In this respect it has to be pointed out above all that it is by no means certain that production capacity in the men's outer wear sector has really gone down by 55 %. The figures submitted by the Italian Government in this respect have not been calculated on the basis of machinery and equipment but by using the reduction in workforce as an indicator. In view of the severe overmanning of the factories in question in 1983, it is highly likely that production output could have been maintained while at the same time considerably reducing the personnel. In any case, and in order to increase productivity, the workforce had to be significantly reduced, because, compared to the private Italian clothing industry, labour productivity in the State owned companies in this sector was much lower, as documented by the Central Italian Statistical Institute (ISTAT) for the years in question here.

Moreover, the reconversions concerned involve transfers to the following subsectors of the textile and clothing industry: jeans, women's outer wear, pyjamas, stockings and tights. All these subsectors are equally highly sensitive at Community level because of depressed prices, stagnant or reduced demand and production, pressure from third countries, a certain degree of overcapacity and very keen and growing intra-Community competition and trade.

The same holds true as far as the situation in the non-textile sectors, leather and shoes, is concerned to which two other production sites were reconverted.

Therefore, it has to be concluded that these reconversions, while possibly and in the end, that is after 1987, somewhat reducing the pressure on the men's outer wear industry in the Community by certain capacity reductions, which, as indicated above, definitely did not go as far as claimed by the Italian Government, at the same time increased the pressure by way of adding capacities in other subsectors of the textile and clothing industry and in other branches of industry where similar or, indeed, identical structural difficulties exist. These difficulties were therefore increased by these reconversions, so that it must be concluded that they did not facilitate the development of the Community industry in these sectors.

X.

In view of all the above considerations and with regard to the exemption provided for in subparagraph 3 (c) of Article 92 of the EEC Treaty in favour of 'aid to facilitate the development of certain economic activities' it must be observed that the aids, while facilitating the development of ENI, which in the mean time has sold Lanerossi and thus its remaining interests in the textile industry, did not facilitate the development of the sectors concerned at Community level and at the same time affected trading

conditions to an extent contrary to the common interest. They artificially kept the men's outer wear factories in business in a sector where there is a high and constantly increasing level of trade in the Community and competition is very keen. They lowered the costs of ENI, weakened the competitive position of other producers in the Community and therefore had the effect of further increasing the pressure on these firms and depressing prices in the Community market, to the detriment of and possible withdrawal from the market of producers which have hitherto survived owing to restructuring, productivity and quality improvements and, indeed, capacity and workforce reductions undertaken from their own resources. Thus, the aids which favoured ENI, which was artificially relieved of costs and whose market position therefore was no longer solely determined by its own efficiency, merits and powers, cannot be considered as contributing to a development which from the Community point of view would be adequate to counteract their trade-distorting effects. Therefore, the aids cannot benefit from the sectoral derogation under Article 92 (3) (c) of the EEC Treaty.

With regard to the exemptions provided for in Article 92 (3) (a) and (c) relating to aids intended to promote or facilitate the development of certain areas, it must be observed that only in some of the areas concerned here (Pescara, Maratea, Nocera, Gagliano) the standard of living is very low and that they suffer from considerable underemployment. In certain other areas concerned here, namely Ancona, Orvieto, Arezzo and Macerata, the standard of living is not abnormally low nor is there serious underemployment within the meaning of the exemption specified in Article 92 (3) (a). The concept of regional development to which the exception of Article 92 (3) (a) is linked is based essentially on the provision of aid for new investment or major expansions or conversions of undertakings involving investments of a physical nature and the costs associated with these. In this case, the interventions in respect of factories that have fallen into financial difficulties and the consequent and successive sanitization of their balance sheets cannot be said to fall under the prescriptions of this derogation.

Moreover, and concerning all regions in question here, it has to be pointed out not only that the Commission must undertake its analysis of the economic and social situation in the framework of the Community interest, which in the sector of men's outer wear is to reduce capacities and avoid State aids in favour of the maintenance of uncompetitive production, and in this way control the sectoral effects of regional aids even in depressed areas, but also that such aids have to promote regional development. Also, the Community gudelines on textile aids specify that the regional aspect of aids must be assessed in the light of the problems of regional development and of their effects on the sector from the viewpoint of competition and intra-Community trade.

In the situation that the industry concerned was and at present is in (and in which it is likely to remain in future), the aids did not make the production plants financially and economically more viable and did not secure the jobs provided. The aids merely kept these sites in business by compensating their operating losses while at the same time employement was being reduced. Therefore, the aids did not promote the economic development of the areas concerned within the meaning of Article 92 (3) (a) and (c), as they did not bring to them any lasting increase in income or reduction in unemployment.

Concerning the regional derogation under Article 92 (3) (c) and in view of the situation of the men's outer wear industry and the other sectors of industry to which some of the sites were reconverted, the aids affected trading conditions to an extent contrary to the common interest.

In view of all the above arguments, the aids did not meet the conditions which must be fulfilled in order to benefit from the regional derogations of Article 92 (3) (a) and (c).

Finally, as regards the exemptions provided for in Article 92 (3) (b), it results from the foregoing that the aids in question were not intended or suited to promote the execution of an important project of common European interest or to remedy a serious disturbance in the Italian economy. Furthermore, the Italian Government has not invoked this derogation.

In view of all the foregoing considerations the aids in question (Lit 260,4 billion) are illegal because the Italian Government did not fulfil its obligations under Article 93 (3). Moreover, they do not meet the conditions which must be fulfilled in order for one of the derogations of Article 92 (2) and (3) to apply.

XI.

As pointed out above, the Commission can in such cases require Member States to recover aid granted illegally from recipients.

In the case at issue here, the amount of aid awarded was a large amount and it even considerably exceeds the amount of other national aid scheme proposals rejected by the Commission on the grounds of potential distortion of competition, such as the French parafiscal levies scheme for the textile and clothing industry (final negative Decision 85/380/EEC [1]), the textile and clothing industry aid scheme put forward by the UK (final negative Decision 85/305/EEC [2]) and the 1984 Belgian textile and clothing industry aid scheme (final negative Decision 84/564/EEC) [3].

Furthermore, the seriousness and scale of the breach of Community legislation in this case requires appropriate measures.

As a result, the total amount of aids illegally granted, that is Lit 260,4 billion, must be withdrawn by recovery,

HAS ADOPTED THIS DECISION:

Article 1

The aids granted between 1983 and 1987 to ENI/Lanerossi in the form of capital injections in favour of the group's men's outer wear subsidiaries and amounting to Lit 260,4 billion are illegal as they were provided in violation of the provisions of Article 93 (3) of the EEC Treaty. Moreover, they are incompatible with the common market within the meaning of Article 92 of the Treaty.

Article 2

These aids shall be withdrawn by recovery.

Article 3

The Italian Government shall inform the Commission within two months of the date of notification of this Decision of the measures taken to comply herewith.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 26 July 1988.

For the Commission

Peter SUTHERLAND

Member of the Commission

[1] OJ No L 217, 14. 8. 1985, p. 20.
[2] OJ No L 155, 14. 6. 1985, p. 55.
[3] OJ No L 312, 30. 11. 1984, p. 27.