II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 25 March 1992

on aid granted by Spain to Industrias Mediterraneas de la Piel SA (Imepiel)

(Only the Spanish text is authentic)

(92/318/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

Imepiel was incorporated in 1882 by the Segarra family who owned and managed the company until its acquisition to stave off bankruptcy by the Spanish State in 1976. At this date the Spanish State, through the Property Office of the Ministery of Economic Affairs (Patrimonio del Estado), acquired 99,94 % of the capital, the other investors being the Caja de Ahorros de Valencia and the Caja de Ahorros de Castellón.

The company manufactures and sells footwear produced from its own preparation of hides (the bulk of which are used and not resold) and from rubber, a purely intermediate product, which is employed to manufacture the soles.

Its premises are located in Vall d'Uxó, in the Castellón province, a town of 27 000 inhabitants 45 km to the north of Valencia, 26 km from Castellón and 15 km from Sagunto, a town which has suffered recently due to the rationalization of the steel industry. The company's premises extend to 150 000 m^2 with buildings occupying some 100 000 m^2 of this.

The company expanded during the post-war years diversifying into complementary activities such as glove making and farming. Since its acquisition by the State such ancillary activities have been eliminated. Despite this the company has always been a leading Spanish footwear manufacturer having the largest workforce and highest production capacity located on one site. However, since rationalization, cuts have been made resulting in a reduction in the workforce from 3 146 in 1976 to 1 457 in 1988.

Throughout the period of public ownership the company has, in general, incurred operating losses each year. Over the 10 years to 1987 these amounted to Pta 12 700 million and a series of capital injections were made to cover these losses. In addition, publicly-funded capital investment expenditure has been incurred in an attempt to modernize the factory.

Faced with continuing losses the majority shareholder commissioned a viability plan in the mid 1980s which foresaw a reduction in capacity due to redundancies; capital injections (1987 : Pta 1 400 million, 1988 : Pta 1 929 million); a managerial shakeup and a reassessment of markets and products.

II

As a result of press reports in December 1987 the Commission learned that the State authorities had prepared a rescue plan for the company and had, allegedly, granted a capital injection amounting to Pta 1 400 million to cover trading losses in respect of 1987.

The Commission requested, by letter dated 29 January 1988, information regarding this capital injection to cover trading losses.

In reply, the Commission received a telex dated 20 April 1988 from the Spanish authorities confirming that a capital injection amounting to Pta 1 400 million had taken place in respect of 1987.

At the request of the Spanish authorities a bilateral meeting, with the Commission, was arranged to discuss the case. This took place on 9 June 1988. At this meeting further information was provided in respect of the company and its history, but most importantly the Spanish authorities informed the Commission that a further capital injection of Pta 1 929 million had been made in respect of 1988.

It was stated that these monies were to be used to restructure the company by way of redundancies. In addition, the Commission was informed that the relevant documentation and an official notification of this transaction would be provided. The information received at this meeting was insufficient to assess the compatibility of these capital injections with the provisions of Articles 92 and 93 of the EEC Treaty.

Following the meeting the Commission, by letter dated 15 July 1988, requested the Spanish authorities to provide the promised notification and further information within an agreed timescale. In reply to this request, the Commission received a letter dated 27 July 1988 from the Spanish authorities formalizing much of the data on the company's background previously provided in the meeting of 9 June.

General details of the company's viability plan were provided; this plan required:

— capital injections of Pta 1 400 million in 1987 and Pta 1 929 million in 1988,

— a managerial strategy to achieve profitability in a short period of time,

— product and market research,

— capital investment to improve plant and machinery.

No specific details or numerical data were provided by this plan although the Commission was promised more detailed information by November 1988.

A further bilateral meeting was held between the Commission and the Spanish authorities on 16 November 1988. This meeting again discussed, in general terms, the need for the company to have further monies to fund a redundancy programme (job losses would be as follows 1989 : 251, 1990 : 275, 1991 : 273), for it to have a restructuring plan and for monies for investment amounting for 1989 to Pta 470 million and for 1990 to Pta 100 million.

The plan, as prepared, apparently foresaw reductions in expenses and production, diversification, sales price increases and productivity gains. All this would lead, in the long run, to the company being eligible for privatization.

As at the previous meeting no data was forthcoming to enable the Commission to judge whether the capital injections were compatible with Articles 92 and 93 of the EEC Treaty.

By letter dated 14 December 1988 the Commission informed the Spanish authorities of the initiation of proceedings in accordance with Article 93 (2) of the EEC Treaty concerning the Pta 3 329 million that the Spanish State had injected into Imepiel. This letter resulted in a request for comments from interested parties being published in the *Official Journal of the European Communities*(1).

The Spanish authorities replied to the Commission's letter on 25 January 1989. They claimed that the money injected into Imepiel (amounting in total to Pta 6 029 million, being 1986 : Pta 1 500 million, 1987 : Pta 2 600 million and 1988 : Pta 1 929 million) had to be viewed in the context of a three-year recovery plan that would result in the privatization of the company.

The recovery plan had the following objectives:

— to return the company to profitability within three years,

— a reduction in capacity: footwear from 3,2 million pairs per year to 1,74 million pairs, hides from 20 million square feet per annum to 14,1 million square feet and the closure of the rubber section,

— a decentralization of the company's organization,

— rationalization of the manufacturing premises with the sale of superfluous space,

— expansion of own brand sales and an attempt to move into higher quality products,

— the avoidance of labour disputes through detailed negotiation,

— a reduction in the workforce from 1 457 to 627.

The plan was flawed in several ways. The company neither earned a profit in 1988 nor 1989; in addition, subsequent plans have indicated that it will not be profitable before 1993. The foreseen reduction in capacity may have been possible but production was, for shoes, 2 million pairs in 1987 and 2 million pairs in 1988. Subsequent plans indicate production in excess of 2 million pairs in 1990 and 1991 and over 3 million for 1992.

(1) OJ No C 28, 3. 2. 1989, p. 7.

Subsequently, on 20 February 1989 the Commission requested further information from the Spanish authorities. The information requested required details of aids granted, aids envisaged, cash flow and profit and loss forecasts, details of the local economy where Imepiel was based, investment details and privatization details.

In a letter dated 17 March 1989 the Commission received details of a proposed offer to purchase the company by a group of Spanish entrepreneurs.

In essence, they offered to purchase the company so long as the State was prepared to pay the following:

— in respect of losses in the first three years of trading after acquisition, Pta 3 358 million,

— for investments Pta 1 695 million,

— for redundancies Pta 11 179 million,

— an amount equivalent to the net current liabilities.

The Spanish authorities replied to the Commission's request in a letter dated 5 April 1989.

This indicated that the Spanish State believed the company had the following requirements:

— capital injections (between 1986 and 1991): Pta 12 835 million,

— cash loss of company (between 1989 and 1993): Pta 4 478 million,

— loss of company (between 1989 and 1993): Pta 61 988 million,

— investment requirements for the company (between 1989 and 1993): Pta 1 006 million.

The authorities concluded that it was still their intention to privatize the company.

By letter dated 18 April 1989 the Commission received details of a revised offer by the private entrepreneurs asking for funds amounting to Pta 17 305 million (as opposed to Pta 16 232 million in their earlier offer).

Between April and November 1989 both the Spanish authorities and the Commission considered the buyers' plans for the company and various correspondence was exchanged on this matter and in connection with the creation of the Vall d'Uxó as a special investment area.

The Commission received a telex dated 9 November 1989 from the Spanish State stating that they were having difficulty in privatizing Imepiel.

Subsequently the Commission received a letter dated 19 December 1989 confirming that privatization negotiations had been broken off and that the Spanish authorities were to carry out the viability plan submitted to the Commission in January 1989.

As a result of this letter the Commission sent a telex dated 11 January 1990 requesting an update on information received from the Spanish authorities.

By letter dated 24 January 1990 the Spanish authorities submitted updated financial information in respect of Imepiel as regards historic and forecast data. More importantly they supplied details of the terms of the proposed privatization of the company together with details of its liquidation value. The sale terms were confirmed by a letter dated 1 February 1990 containing a copy of the sale and purchase agreement that was dated 10 January 1990.

Broadly the sale terms were as follows:

— the purchaser was a company (Circulo de Financiación y Gestión SA, having a share capital of Pta 2 500 million which was 25 % paid up. The balance was to be paid up within three years. This indicates that the acquirer was undercapitalized and consequently would have an effect on the long-term viability of the project,

— the purchase price was Pta 100 million,

— the purchaser was to retain ownership of Imepiel for three years, was not allowed to change the purchaser's share capital structure nor that of Imepiel during this time except as authorized by the State,

— the vendor will, on sale, provide a capital injection of Pta 8 500 million to be used for improving the company's financial position, restructuring the workforce and making appropriate investments in equipment.

With the same letter the purchaser provided to the Commission a financial plan which was subsequently revised (for years 3 and 4) by letter dated 30 January 1990.

A summary of the financial aspects of this plan together with actual data in respect of 1989 and 1994 is set out below:

Year	Product	Sales volume	Sales value (1)	Result (1)	Investment (1)
1989	Shoes	1 250 (2)			
	Hides	8 600 (3)			
			5 481	(2 309)	?
1994	Shoes	3 445 (2)	7 471		
	Hides	15 500 (3)	4 286	446	164

(1) Pta million.
(2) Thousands of pairs.
(3) Thousands of square feet.

It is obvious from the above that the purchasers' targets are ambitious. Given the history of the company and the lack of any detailed assumptions to support this forecast there is no solid base for it to be achieved. Far more importantly the purchaser intends to increase volume which will have the effect of increasing the pressure on the market.

A bilateral meeting was held between the Commission and the Spanish authorities on 26 January 1990. At this meeting the Commission services stressed the fact that the restructuring plan was unacceptable given the fact sales volume increases. The Spanish said that the base year for comparison should be 1986 when 3 million pairs were sold and not 1989; in addition, the authorities confirmed that sales of 3 million pairs was the breakeven point even with a workforce of 770. Moreover it was admitted that several offers had been received for Imepiel but that the most appropriate was the one accepted.

Imepiel was privatized on 2 February 1990.

As a result of the privatization the Commission extended its procedure under Article 93 (2) to take account of the following further amounts of aid:

— capital injections: 1986: Pta 1 500 million, 1987: Pta 1 200 million,

— on privatization: Pta 8 500 million,

— bargain price arising on privatization: Pta 3 900 million.

This decision was communicated to the Spanish authorities by letter dated 3 August 1990, and subsequently published in the *Official Journal of the European Communities*(1).

By letter dated 11 October 1990 the Spanish authorities responded setting out their objections to the extension of the procedure.

III

The Commission decision to initiate Article 93 (2) procedures, notified to the Spanish Government by letter dated 14 December 1988, invited the Spanish authorities to submit their observations and to provide the detailed information requested therein as well as any other information they might consider relevant for the Commission to assess the compatibility of the aid.

The other Member States and interested third parties were informed of the Commission's decision by the publication of the letter in the *Official Journal of the European Communities* dated 3 February 1989.

In the correspondence already noted above the Spanish Government submitted its observations by letter dated 25 January 1989, and, following questions submitted by the Commission, provided further information in a letter dated 5 April 1989.

Firstly, the Government considered that the aid granted was compatible with the provisions of Article 92 (3). Secondly, the Government believed that the aid had to be viewed in the light of the privatization programme, the recovery plan and measures needed to boost the local economy.

Apparently attempts had been made to privatize the company which had failed due to the inability of the buyers to provide the requisite guarantees. The recovery plan would be used in conjunction with measures designed to boost the local economy and consequently the aid could be justified.

The Government argued that the aid is linked to the restructuring of the company and is primarily short-term although medium-term resources may be needed. The aid was proportionate to the problem it was designed to resolve and therefore competition in the footwear sector would not be distorted. Industrial problems and unemployment would not be transferred to other Member States as the company's intra-Community exports were only Pta 706 million in 1988 (10,92 % of turnover) and were expected to fall: consequently maintaining the company would help alleviate structural problems in the Community. If the company was allowed to fail the gap may be filled by third countries.

The Government also pointed out the provisions of the Treaty regarding Spain's accession to the Community with respect to Articles 92 and 93.

In summary the Spanish authorities confirmed their intention to sell the company and that a restructuring plan was crucial to enable this to take place with the minimum of distortion in the local economy.

As part of the procedure other Member States submitted comments on the capital injections:

— the UK Government shared the Commission's opinion as to the incompatibility of the aids,

— the Danish, German, Portuguese and Italian Governments also all supported the Commission's position.

The extension of the Article 93 (2) procedure to cover the further aid granted to the company, together with the aids on privatization, was notified by letter dated 3 August 1990 to the Spanish Government and published in the

(1) OJ No C 320, 20. 12. 1990, p. 18.

Official Journal of the European Communities on 20 December 1990 inviting comments from other Member States and interested parties. The Spanish Government replied by letter dated 11 October 1990.

Firstly, the Spanish authorities disagreed with the Commission's conclusion that the 1986 and 1987 aids (Pta 3 700 million) and privatization aids (Pta 3 900 million) constituted aids that could not be exempted. This was based on the fact that the Spanish believed that the aid granted complied with Community rules since it was designed to bring government funding to an end whilst ensuring the viability of the company and the economic development of a less favoured area. This opinion was supported by the fact that many of Imepiel's problems arose out of pre-accession industrial policies.

The Government did not consider that the sale involved aid as it believes that the value of the company on disposal should not be computed on the basis of net assets but on the basis of the present value of future returns. This is supported by the fact that Imepiel was sold to the highest bidder.

In addition the response considered the buyer's plans for the company including investment and a restructuring of the workforce and the productive capacity. Capacity would be cut and therefore the company would have a smaller impact in the market place.

Furthermore, the social aspects of the problem were stressed: the company is located in a town of 27 000 inhabitants where 2 000 are unemployed. Winding up the company would be expensive not just in dismissal costs but in respect of the ongoing unemployment and re-training costs. In essence the Spanish authorities considered this to be an exceptional case and believed that all aids granted were compatible with the Treaty.

As a result of the publication of the letter in the *Official Journal of the European Communities* a response was obtained from the UK-based British Footwear Manufacturers Federation. This stressed that Spanish imports had increased in the UK and that these shoes competed at the lower end of the market where competition was price and not quality based. Therefore, any State aid enabling a manufacturer to reduce his sales price would have a negative effect on competition.

On 18 March 1991 a meeting was held between Commission officials and representatives of Patrimonio to consider Imepiel's restructuring plan.

The main points raised by the Commission concerned the necessity of the recovery plan to:

— provide for a reduction in the production capacity, sales and market share,

— ensure the viability of the company,

— not involve aids exceeding the minimum necessary requirements.

Moreover, the officials of the Commission stressed that due to the conditions attached to the sale contract, the bid for Imepiel cannot be considered to be open and unconditional, and in addition, the company had benefited from capital injections which allowed it to continue to operate for a long time at an artificially-maintained level.

During the same meeting the Patrimonio representatives reminded the Commission that the present condition of Imepiel was the consequence of pre-accession policies and confirmed their comments already supplied following the opening of the Article 93 (of the EEC Treaty) procedure. In addition, they affirmed that any reduction in the productive capacity or in the market share of the company would undermine its viability.

A record of this meeting was communicated to the Spanish authorities on 18 April 1991 together with a detailed list of information to be supplied in order to enable the Commission to assess the case further.

To date no further information has been received.

IV

On its examination of the capital contributions of 'Patrimonio del Estado' to Imepiel between 1986 and 1989 and at the time of its privatization, as well as the other terms of the sale contract with Circulo de Financiación y Gestión SA, the Commission has verified to what extent these public interventions contain State aid elements within the meaning of Article 92 (1).

It should be noted that 'Patrimonio del Estado' is an intrinsic part of the Spanish State with the status of Directorate-General dependent upon the Spanish Ministry of Economic Affairs. Its financial requirements are wholly provided by the State on the basis of budgetary appropriations. Accordingly, the financial resources of 'Patrimonio del Estado' are to be considered as resources of the State and, consequently, the capital contributions provided to Imepiel constitute public interventions.

The provision of public funds to companies in the form of capital contributions may involve elements of State aid if those funds are provided in circumstances that would not be acceptable to a market-economy investor operating under normal market conditions. This is the case, among others, where the financial position of the company, and particularly the structure and volume of its debt, is such that a normal return — in dividends or capital gains — cannot be expected within a reasonable time from the capital investment, or where, because of its inadequate cash flow if for no other reason, the company would be unable to raise the funds needed for an investment programme on the capital market. This position was made known by the Commission in its letter to the Member States of 17 September 1984 on the application of Articles 92 and 93 of the Treaty to public authorities' holdings. In this respect, it should also be noted that, recently, in its communication of 24 July 1991 introducing a new reporting system to identify when aid is present in financial flows between public authorities and publicly owned companies, the Commission has reminded Member States of the principles it will use in determining whether aid is involved in such State interventions (see Part III of the communication).

Moreover, the Court of Justice of the European Community has clarified the application of Article 92 (1) in respect of public holdings (see Judgments in Cases 323/82 (Intermills) [1], 234/84 (Meura) [2] and 40/85 (Boch) [3]). The Court has also distinguished the actions of minority, from those of majority, shareholders as regards the provision of capital (see Judgments in Cases 305/89 (Alfa Romeo) [4] and 303/88 (ENI-Lanerossi) [5]). In order to determine whether a capital contribution 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.

At the time of the first post accession provision of capital by 'Patrimonio del Estado' in 1986, Imepiel had made overall losses for the previous 10 years, and the State had already been obliged to recapitalize the company on repeated occasions to keep it in business. As all this investment did not result in a capital return, it is unlikely that a market economy investor, basing his decision on foreseeable profits, and disregarding any social, regional or sectoral considerations, would have provided Imepiel with successive capital increases totalling Pta 6 029 million between 1986 and 1988.

Consideration must be given as to whether any State aid was involved in the acceptance by the State of a nominal sales price for Imepiel amounting to Pta 100 million.

The sales procedure for the company was conducted on an open market basis by advertising through various international banks and similar bodies. The details of several offers were communicated by the Spanish authorities to the Commission and this information indicates that the net cost for the Spanish State (i.e. capital injection less purchase price) in respect of the chosen purchaser was the lowest.

Furthermore, the fact that the company had not earned a profit in recent years and that its plans for the future indicate that there will be several years of losses mean that its value was minimal. Most importantly it should be noted that the company's accounts, at 31 December 1989, displayed that it had net liabilities of Pta 135 million indicating that its value was negligible.

Consequently, it is considered for these reasons, together with the fact that the sale contract required the purchaser to maintain his investment for three years, that the sale price of Pta 100 million can be accepted.

The sale took place on the basis that a capital injection of Pta 8 500 million would be made by the Spanish State and was necessary in order to attract a buyer for the company. In order to determine whether any State aid existed in this capital contribution it is necessary to verify the rationality of the State's behaviour as a market-economy investor. A market-economy investor intending to maximize the profitability of his investment would have only made the capital contribution if, later on, this action would have made him better off, in economic terms, taking into account the sale as a whole. However, the monetary return for the capital contribution was limited within the framework of the sales contract to Pta 100 million which cannot be considered to be an adequate return for the investment.

At the extension of the Article 93 (2) procedure it was considered that an element of aid existed in the sale price given that the buyer believed Imepiel to be worth Pta 4 000 million subsequent to the State's capital injection at the time of sale. This was considered possible on the grounds that the capital injection of Pta 8 500 million may have been compatible with the Treaty. On subsequent reflection, it is believed that the sale price does not contain an additional element of aid.

[1] [1984] ECR 3809.
[2] [1986] ECR 2263.
[3] [1986] ECR 2321.
[4] [1991] ECR I-1603.
[5] [1991] ECR I-1433.

The Spanish authorities provided a liquidation value for Imepiel, as at 31 October 1989, amounting to minus Pta 1 436 million. Furthermore, they argued that redundancy costs of Pta 5,5 million per employee had to be met, amounting in total to Pta 7 909 million. These costs of Pta 9 345 million, they argued, were in excess of the capital contribution on privatization and therefore the State took the proper economic decision.

It should be noted that, contrary to the observations of the Spanish authorities, the option to wind up Imepiel does not appear more costly to the State than the preferred option to sell the company on the accepted terms. The State, as owner of the company, would not have been obliged to cover the balance between the proceeds from the liquidation of the assets and the liabilities linked to winding up Imepiel, given that a joint stock company limits its responsibility to honour debts up to the liquidation value of its assets, and in normal circumstances, the owner of the company does not take on any responsibility for any further deficit.

It is important to note that in an analysis of the liquidation costs of a company the State must separate itself as the owner/shareholder in a company and as a body responsible for the payment of unemployment/social security benefits.

In assessing the behaviour of the State against that of a market economy investor, the Commission must apply the test 'whether in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional-policy and sectoral considerations, would have subscribed the capital in question' (Judgment in Case 234/84 (Meura), ground 14). If these costs were considered by the Commission, it would amount to granting Member States the power to rescue companies in difficulties on the basis of reasons of pure national interest. This situation, that could create serious distortions of competition contrary to the common interest, would be in contradiction to the principles of the EEC Treaty empowering the Commission to determine the compatibility of State assistance in the context of the Community as a whole and not in that of a single Member State.

Therefore, in summary, after detailed examination, the Commission has arrived at the conclusion that the State aid granted to Imepiel is comprised of the Pta 6 029 million corresponding to capital contributions from 'Patrimonio del Estado' during the period 1986 to 1988, and aid of Pta 8 500 million arising from the last capital contribution from 'Patrimonio del Estado' before the company's privatization; all these monies artificially strengthened Imepiel's financial position.

This aid to Imepiel affects trade between Member States and distorts or threatens to distort competition in the common market within the meaning of Article 92 (1).

In fact, where financial assistance from the State strengthens the position of certain enterprises compared with that of others competing with them in the Community, it must be deemed to affect those other enterprises (Judgment in Case 730/79 (Philip Morris)) [1].

It should be noted that the market, in which the goods produced and sold by Imepiel, is highly competitive. Community footwear production amounts to 1 050 million pairs of shoes and is following a declining trend which has caused a shrinkage of about 15 % since 1986.

The total market is about 1 290 million pairs and the intra-Community trade involves about 440 million pairs (42 % of the production, 34 % of the market). The industry assembly employs 360 000 people directly and another 140 000 people for indirect and ancillary (hides and components) production; the sector is characterized by its fragmentary structure with a large number of small businesses (about 15 000 units with an average workforce of 24).

In 1986 Spain had some 14 % of the Community market in terms of production of which 61 % was exported; as the company is a significant producer in terms of the number of personnel employed and is an above-average shoe producer, in volume terms, it takes a more than marginal share in the Community market. Moreover, as the market is more price than volume orientated the financial assistance granted by the State is bound to have a significant negative effect on competition. It allows Imepiel to continue on a level which it would not have been able to maintain with its own resources. Thus it retains an artificially high market share and transfers its redundancy problems to its competitors. Even if Imepiel does not participate significantly in the Spanish export market, its artificial presence in the Spanish market makes market penetration by other Community producers more difficult. (See the Judgment in Case 102/87 (France v. Commission)) [2].

[1] [1980] ECR 2688.
[2] [1988] ECR 4067.

V

Concerning the legal status of the aid to Imepiel under Community law, it has to be concluded that it is illegal, since the Spanish Government failed to notify it in advance to the Commission as required by Article 93 (3).

The situation produced by this breach of the Treaty provisions is particularly serious since the aids in question have already been paid to the recipient. 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) which also are of importance as regards public policy — the direct effect of which the Court of Justice has recognized in its ruling in Cases 77/72 (Capolongo) (1), 120/73 (Lorenz) (2) and 78/76 (Steinicke) (3), the illegality of the aid at issue here cannot be remedied *a posteriori*.

Notwithstanding this, it should be noted that the Commission is obliged to carry out its due procedures in relation to Article 93 (2) as recognized in the Court of Justice ruling in case 301/87 (Boussac Saint Frères) (4).

VI

Article 92 (1) of the EEC Treaty provides that aid meeting the criteria laid down therein is in principle incompatible with the common market.

The exceptions provided for in Article 92 (2) are not applicable in this case because of the nature of the aid which is not directed towards the attainment of such objectives.

Article 92 (3) of the Treaty lists aid which may be compatible with the common market. Compatibility with the Treaty must be determined in the context of the Community as a whole and not in that of a single Member State. In order to ensure the proper functioning of the common market, and having regard to the principle embodied in Article 3 (f), the exceptions provided for in Article 92 (3) must be construed narrowly when any aid scheme or individual aid award is scrutinized. In particular, they may be invoked only when the Commission is satisfied that, without the aid, market forces alone would be insufficient to guide recipients towards patterns of behaviour that would serve one of the objectives of the said exceptions.

Applying the exceptions to cases which do not contribute to such objectives or where the aid is not necessary for those purposes would amount to conferring advantages on the industries or firms of certain Member States, whose financial position would be artificially strengthened and to affecting trade between Member States and distorting competition without any justification based on the common interest, as referred to in Article 92 (3) of the Treaty.

The company was granted aid by the Spanish authorities in the form of capital injections, between 1986 and 1988 amounting to Pta 6 029 million.

The Commission can share the Spanish authorities' view that these capital contributions from 1986 to 1988 were made in response to circumstances which developed prior to Spain's accession to the Community.

Preaccession industrial policy in Spain, in respect of public companies, was sometimes based on principles radically different from those employed in formulating the competition policy of the EEC Treaty. At that time, certain loss-making public companies were maintained on poor managerial principles and were kept in business artificially thanks to financial assistance from the State. After Spain's accession to the Community, these companies have been forced to adapt to an environment of fair competition. The aids to Imepiel in question were mainly aimed at facilitating that adaptation. It should be noted that this assistance represented a significant effort to create a basis for the definitive restructuring of the company.

Therefore, as far as the capital contributions of Pta 6 029 million between 1986 and 1988 are concerned, the Commission has arrived at the conclusion that they can be considered as compatible with the common market pursuant to the exception provided for in Article 92 (3) (c).

With respect to the aid contained in the injection of Pta 8 500 million made in the context of the privatization it has to be examined if one of the derogations of Article 92 applies.

Article 92 (3) (a) and (c) lays down an exception for aid that promotes or facilitates the development of certain areas. In this respect, Imepiel is situated in Vall d'Uxó, an area which does not present a standard of living abnormally low, or serious underemployment, within the meaning of Article 92 (3) (a). As regards the application of the exception of Article 92 (3) (c) on regional grounds, in Vall d'Uxó the Commission has accepted that grants up to a maximum of 30 % of productive capital investments (Commission Decision of 15 June 1989) can be made by a derogation under Article 92 (3) (c).

The decision to accept this area as eligible for regional aid was taken by the Commission, amongst other reasons, to stimulate diversification investment, in particular as a safety net for the redundancies at Imepiel, and not to aid

(1) [1973] ECR 611.
(2) [1973] ECR 1471.
(3) [1977] ECR 595.
(4) [1990] ECR I-307.

Imepiel itself. Furthermore, the aid in question was made on the basis of an *ad hoc* decision of the Spanish Government taking the form of a discretional capital contribution and not a grant to create productive capital investment. Consequently, as a result of the above a regional derogation under Article 92 (3) (c) is not possible.

Moreover, the capital contribution, upon privatization, of Pta 8 500 million did not have the requisite features of aid to facilitate the development of certain economic areas inasmuch as it was made in the form of operating aid to a firm in difficulties. That is to say the capital contribution was not conditional on investment or job creation as explained in the Commission's communication in 1979 on the principles of the coordination of regional aid.

Even if the Commission were to consider the capital contribution under regional guidelines the aid could only be justified if, firstly, it contributed to the real and long-term development of the region leading to the viability of the undertakings concerned and, secondly, if the undertaking had, as a contributing factor, a restructuring plan which enhanced the competitive situation.

Consequently, the capital contribution cannot be considered to 'facilitate the development of certain economic areas where such aid does not adversely affect trading conditions to an extent contrary to the common interest'. A derogation under Article 92 (3) (c) cannot therefore be granted for this aid.

As regards the exceptions provided for in Article 92 (3) (b) the aid measures in question were not intended nor have the features of a project of common interest or of a project likely to remedy a serious disturbance in this Spanish economy. Moreover, the Spanish authorities have not invoked this exception in their observations to the Commission.

As regards the exception provided for in Article 92 (3) (c), for aid to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, it should firstly be noted that the aid to Imepiel falls under the category of aid to companies in difficulties, as both the company's financial position and financial record have always been precarious. Aid to firms in difficulties carries the greatest risk of transferring unemployment and industrial problems from one Member State to another; it acts as a means of preserving the *status quo* by preventing market economy forces from their normal consequences in terms of the disappearance of uncompetitive firms in their process of adaptation to changing conditions in competition. For this reason the Commission takes a strict approach in assessing the compatibility of aid for restructuring firms in difficulty. In particular, the Commission requires that such public intervention be strictly conditional on the implementation of a sound restructuring or conversion programme capable of restoring the long-term viability of the beneficiary, it must also contain a compensatory justification for the aid in the form of a contribution by the beneficiary or to the development of the sector as a whole on a Community level by a reduction of its presence in the market.

The capital injection of Pta 8 500 million made at the time of privatization should allow the company to repay loans (Pta 4 000 million) and make redundancies (Pta 3 000 million). The balance is to be used to provide working capital for the company's operations.

It should be noted that these three actions will have an effect on the future competitivity of the company which would, otherwise for the aid, have had to have been met from the company's own resources.

The purchasers have provided a plan for the company's future (which was subsequently revised) which indicates, in fact, that production will be increased and not reduced as would be necessary to make the restructuring in the interest of the sector concerned on the level of the Community.

As a result of the fact that upon privatization the Commission was not presented with a restructuring plan which :

— demonstrated the company's future viability,

— portrayed a reduction in the company's productive capacity, and

— showed a decrease in the company's presence in the market place.

It cannot be considered that this restructuring facilitated the development of economic activity compatible with the common interest. Consequently, this aid is incompatible with Article 92.

By letters dated 7 June and 18 July 1991, the Spanish authorities requested the Commission to postpone any decision in respect of this case until they could submit an alternative restructuring plan that was currently being negotiated with Imepiel.

By letter dated 6 August 1991, the Commission informed the Spanish authorities that, in view of the fact that two additional months had already elapsed since the expiration, on 31 May 1991, of the last deadline for the submission of an alternative restructuring plan, it could not delay further the taking of a final decision.

VII

In conclusion, in the light of the foregoing considerations, the State aid element to Imepiel of Pta 8 500 million involved in the terms of its sale to Circulo de Financiación y Gestión SA is illegal under Community law, since it was awarded by the Spanish Government in violation of the provisions of Article 93 (3).

However, the aid of Pta 8 500 million should be reduced by the sales proceeds of Pta 100 million in order to reflect the net cost of the transaction to the State. By such a netting procedure both the benefit to the acquirer, Circulo de Financiación y Gestión SA, and the cost to the State are fully reflected.

Furthermore, the said aid element does not meet the conditions which must be fulfilled in order for one of the exceptions of Article 92 (2) and (3) to apply, for which reason it is moreover incompatible with the EEC Treaty.

In case of aid which is incompatible with the common market, the Commission, making use of a possibility given to it by the Court of Justice in its Judgment in Case 70/72 (Kohlegesetz) [1], confirmed in the Judgment in Case 310/85 (Deufil) [2], can require Member States to recover from recipients aid granted illegally,

HAS ADOPTED THIS DECISION:

Article 1

The aid granted of Pta 6 029 million between 1986 and 1988 was granted illegally as it was granted in breach of the procedural rules of Article 93 (3).

Notwithstanding this the aid meets the conditions for a derogation under Article 92 (3) (c) and is therefore compatible with the common market.

Article 2

The net State aid of Pta 8 400 million (i.e. capital injection of Pta 8 500 million net of sales proceeds of Pta 100 million) contained in the capital contribution provided by Patrimonio del Estado to Imepiel simultaneously with its privatizations on 2 February 1990 is illegal under Community law, since it was awarded by the Spanish Government in violation of the provisions of Article 93 (3).

Furthermore, the said aid does not meet any of the conditions which must be fulfilled in order for one of the exceptions of Article 92 (2) and (3) to apply, for which reason it is incompatible with the common market.

Article 3

The incompatible State aid shall be withdrawn by way of recovery. Accordingly, Patrimonio del Estado shall recover Pta 8 400 million from Imepiel.

The aid element shall be recovered in accordance with the procedures and provisions of national law, in particular those relating to interest on arrears payable on State liabilities, with interest starting to run on the date on which the illegal aid was granted.

Article 4

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

Article 5

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 25 March 1992.

For the Commission

Leon BRITTAN

Vice-President

[1] [1973] ECR 813.
[2] [1987] ECR 901.