II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 31 July 1992

concerning proposed aid by Germany to the Chinese shipping company Cosco for the construction of container vessels

(Only the German text is authentic)

(92/569/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 regard to Council Directive 90/684/EEC of 21 December 1990 on aid to shipbuilding [1], and in particular Article 4 (7) thereof,

Having given notice in accordance with Article 93 to interested parties to submit their comments and having regard to these comments,

Whereas :

I

Following a letter of 4 March 1991 from a Community yard complaining that distortion of competition would result from the German Government's intention to grant development aid to a Chinese shipping company for the construction of four container vessels, the Commission, by letter of 2 April, invited the German authorities to notify the project pursuant to Article 4 (7) and 11 (2) (c) of Directive 90/684/EEC. By letter of 22 April, the German authorities stated that a negative decision had been taken on a request from a shipbuilding consortium (Bremer Vulkan, HDW and ex-GDR yards) for financial support on certain development aid conditions for the shipbuilding contract of Cosco (China Ocean Shipping Company).

Following another complaint from the same yard on 12 August 1991 the Commission, by letter of 28 August 1991, again invited the German authorities to notify the development aid plans relating to the Cosco contract. The German authorities, by letter dated 19 September 1991, stated that the question of whether and to what extent development aid could be granted for the Cosco contract was awaiting a project assessment by the Kreditanstalt für Wiederaufbau.

However, on 20 September 1991, the German authorities notified to the Organization for Economic Cooperation and Development (OECD) under the development aid provisions of the OECD Understanding on export credit for ships the terms and conditions of a subsidized loan related to a project to build three 3 765 teu container vessels for Cosco.

The Danish Government, in a letter of 2 October 1991, complained to the Commission about the Cosco aid project.

The Commission, by letter of 14 October 1991, gave the German authorities a final 10 working days to notify the Cosco aid project. The German answer came in two letters dated 31 October 1991 and 4 November 1991 respectively.

[1] OJ No L 380, 31. 12. 1990, p. 27.

II

According to information available to the Commission, the transaction between the German yards and Cosco concerned the building of three 3 765 teu container ships and one 2 700 teu container ship.

In its notification, the German Government gave the following information regarding the details of the case. Cosco, of Peking, ordered three container ships of 3 765 teu each, for a total price of DM 604 140 000. The following yards were mentioned as those which would build the ships : Bremer Vulkan (Bremen), HDW (Kiel), Mathias-Thesen-Werft (Wismar) and Warnow-Werft (Warnemünde).

The following details were given with regard to the loan : the loan would cover 90 % of the contract price with a duration of 11 years and an annual interest rate of 3,5 %. These conditions result in an OECD grant element of 25,35 %. As the Commission had raised questions relating to the price of the ships the German Government, in its notification, responded that the high price per 3 765 teu container vessel is related to the high quality and speed specifications (24 knots) of these vessels. The German authorities considered that the contracts involved a normal commercial price for the ships, once deductions were made for the speed and quality specifications (DM 15 million), the cost of prefinancing and credit insurance, and the normal operating aid ceiling (13 % in 1991). In their view, the Commission should incorporate in its assessment the long-standing satisfactory procedure as regards development aid. The German Government also stated that incorporation of price considerations in the Commission's assessment of the development aid project would create uncertainty in the award of shipbuilding contracts.

In terms of the development content of the aid, the German authorities stated that it was intended to help China to cover a greatly increased transport need and save hard currency by boosting exports. The container ships would further the development of an integrated transport system (door-to-door transport). In the Chinese eighth five year plan 1991 to 1995 a major objective — in addition to that of acquiring or saving foreign currency to a greater extent — is the maintenance of maximum independence from foreign countries with regard to overseas transport. The increased transportation need should be seen against a background of economic growth in China and also the relatively underdeveloped rail and inland waterways system.

III

The loan to Cosco has to be assessed in accordance with the provisions of Article 4 (7) of Directive 90/684/EEC. Article 4 (7) states that the aid for shipbuilding and ship conversion granted as development aid is not subject to the prevailing common maximum aid ceiling of Article 4 (2).

By letter SG(89) D/311 of 3 January 1989 the Commission informed the Member States that such aid is subject to prior individual notification to the Commission, which will verify the specific development content of the proposed aid. the letter goes on to indicate a number of criteria which must be complied with so that the Commission can satisfy itself that the proposed aid falls within the scope of the OECD Understanding on Export Credits for Ships. these include the requirement that the grant element should be at least 25 % of the contract value and that the recipient country should be on the list of 'eligible' countries.

China is on the list of eligible countries and the credit conditions for the Cosco contract notified under the OECD Understanding on Export Credits for Ships appear to be just over the minimum 25 % grant equivalent.

In spite of the German authorities' explanations in their letters of 31 October 1991 and 4 November 1991 stating its development considerations and previous practices as regards development aid relations with China, the Commission still had serious doubts about the genuine development aid character of the proposed aid, due among other things to the lack of transparency on the pricing aspect.

In view of the fact that it had received information indicating that the prevailing market prices for the container vessels in question were 20 to 30 % below the reported contract price of DM 600 million for the three 3 765 teu container vessels, it was not clear to the Commission whether the proposed aid should be considered as development aid to China or as operating aid to the German shipyards concerned. The replies of the German authorities dated 31 October 1991 and 4 November 1991 did not contain any information which allowed the doubts surrounding the alleged overpricing to be eliminated.

Strong reactions from the shipbuilding market reinforced the impression of overpricing by the German yards. In this context, financing support under the heading of development aid was seen more as an operating subsidy in favour of the German shipbuilding industry by allowing the normal aid ceiling to be exceeded rather than as genuine development aid.

The Commission also took into account the fact that the vessels in question were intended for Cosco's worldwide services, probably operating between Europe and the Far East.

The Commission thus still had serious doubts as regards the genuine development character of the proposed aid. The involvement of yards situated in the former German Democratic Republic was a further complicating factor as the Commission had not, at that time, received an official notification of operating aid schemes for the Mecklenburg-Vorpommern shipyards and therefore had not authorized the granting of any aid to these yards.

Finally, it was not clear to the Commission how the one 2 700 teu container vessel fitted into the Cosco project as a whole or in which yard this vessel would be built and which level of support under which schemes would be made available for that part of the contract.

Against this background the Commission decided to initiate the Article 93 (2) procedure in order to allow it to examine the genuine development aid character of the aid project to build three 3 765 teu container vessels and one 2 700 teu container vessel, which could form part of this aid project, for Cosco and assess its overall compatibility with the common market.

IV

After giving notice of the initiation of the procedure (1) the following Member States and other parties concerned submitted their comments :

— the United Kingdom,

— the Danish Government,

— the European Community Shipowners' Associations,

— the Association of Danish Shipbuilders,

— the Danish Shipowners' Association.

In summary, the comments received referred basically to the two following points :

1. the prices quoted for the three container vessels by Bremer Vulkan were above the going market price which would be justified in a normal competitive situation. Therefore serious doubts were expressed regarding the genuine development character of the proposed aid which was viewed rather as a subsidy to the shipbuilding industry ;

2. the granting of the aid would lead to the distortion of competition in the shipping market. This claim was based on the fact that Cosco, which is the world's fifth largest container shipping company and constitutes a strong competitor to Community shipowners by pursuing an aggressive freight pricing policy, would, by virtue of the subsidy, be able to upgrade the quality of its fleet, increase its carrying capacity and maintain its low freight rate policy to the detriment of Community shipowners.

(1) OJ No C 22, 29. 1. 1992, p. 4.

The comments received from the other Member States and parties concerned were transmitted by the Commission to the German Government by letter dated 18 March 1992 to give the German Government the opportunity to submit a reply.

V

The German Government reacted to the opening of the procedure by letters dated 4 March 1992 and 1 July 1992 and faxes dated 10 July 1992 and 3 July 1992. By letter dated 13 April 1992, the German Government reacted to the comments of other Member States and parties concerned. Its comments can be summarized as follows :

1. The German Government explained that the price is based on a market price assessment for a 3 765 teu container ship of DM 142 million taken from the *Study of the Shipbuilding Market 1991* (November 1991), made for the Commission by an independent consultant.

   The actual price for the Cosco ships is higher (DM 201,4 million per ship) as some of the specifications differ in the following respects :

   — the higher speed (25 instead of 21 knots) required a stronger motor and an increase in the length of the ship. The ships will therefore be able to carry more containers (4 070 teu) and more cool containers. This last specification requires extra energy supply for which a new type of control system will be used. This results in additional costs of: DM 25 million,

   — in contrast to the consultant's study which was based on payment in cash (5 × 20 % during building time) it was agreed that 10 % would be paid on signing the contract and 90 % upon delivery. The additional prefinancing costs amount to: DM 7 million,

— furthermore, the yard has to pay a credit-insurance-premium (except in the event of a cash payment as in the consultant's study) of: DM 12 million,

— in the consultant's study no account is taken of the price of the containers so that the cost of containers and supplementary equipment must be added to the basic price: DM 15 million,

DM 59 million.

The additional costs of DM 59 million lead to a final price of DM 201 million in comparison to the consultant's basic price of DM 142 million.

2. The German Government states that the aid is in the nature of development aid since the relevant criteria (see Article 4 (7) of Directive 90/684/EEC and Commission letter SG(89) D/311 of 3 January 1989) are fulfilled, i.e.:

— a 25,35 % credit equivalent,

— the aid is aimed to support the opening of China's foreign trade as well as to improve its economic and social development,

— China is on the list of eligible countries.

3. Regarding the feared distortion of competition in the shipping market the German Government pointed out that Directive 90/684/EEC does not forbid development aid for the construction of merchant ships.

4. The German Government stated that the smaller 2 700 teu container vessel to be delivered to Rubymonte Maritime Inc., a subsidiary of Cosco, will be financed without development aid and in accordance with normal OECD conditions.

5. The German Government stated that of the yards in the former German Democratic Republic only the Mathias Thesen yard would be involved in the constructin of the 3 765 teu vessels. A derogation from Directive 90/684/EEC in favour of the shipyards in the former German Democratic Republic was adopted by the Council on 20 July 1992. It also stated that the Mathias Thesen yard would not reduce its capacity below 87 275 cgt (as at 1 July 1990). The German Government reasons therefore that a decision on the Cosco case does not have to await agreement on the timetable of the 40 % shipbuilding capacity reduction in the former German Democratic Republic required under the derogation.

VI

According to Article 4 (7) of Directive 90/684/EEC, aid for shipbuilding granted as development aid is not subject to the normal ceiling for operating aid and may be deemed compatible with the common market if it complies with the OECD Understanding on Export Credits for Ships. By letter of 3 January 1989, the Commission informed the Member States of its interpretation of Article 4 (7) of Directive 90/684/EEC. It repeated that any individual aid proposal was subject to prior notification to the Commission which would verify, on the basis of the notification, whether the proposed aid constituted development aid and whether it fell within the scope of the OECD Understanding. It also investigates whether the proposed aid complies with the criteria laid down in OECD Document C/WP6 (84)3 of 18 January 1984 concerning the interpretation of Article 6 of the Understanding on Export Credits for Ships according to which the following basic criteria must be adhered to by Member States granting development aid:

1. the aid may not be granted for the construction of ships which will be operated under a flag of convenience;

2. in the event that the aid cannot be classified as official development aid in the framework of the OECD Understanding the donor must confirm that the aid is part of an intergovernmental agreement;

3. the donor must provide proof that the owner is resident in the recipient country and that the recipient company is not a non-operational subsidiary of a foreign company;

4. the recipient must give undertakings not to sell the ship without prior Government approval;

5. the grant element must be at least 25 % of the contract value in accordance with the OECD method of calculation (see OECD Document C/WP6 (85)62 of 21 October 1985);

6. the country involved must be on the Commission's list of countries eligible for development aid under Article 4 (7) of Directive 90/684/EEC.

It is clear from the above that the Commission is required to establish whether the aid granted in respect of each individual contract and liable to individual notification according to Article 11 (2) of the Directive constitutes development aid and whether the other criteria and conditions are met. In relation to the Cosco contracts, the Commission would make the following remarks :

1. The German authorities explain the higher contract price for the three ships by reference to the different specifications (higher speed, etc.) and the extra financial costs due to the soft loan conditions. Even after these explanations the price remains at the upper end of the prevailing market prices for this type of ship. However, the Commission is not in a position, on the basis of the information available to it, to demonstrate that the pricing package acts as an aid to the shipbuilding yards.

2. The German authorities point to China's increased transport needs and the resulting possibility of earning or saving more hard currencies through imports and exports. It also mentions China's objective of maintaining maximum independence from foreign countries for overseas transport and the relatively underdeveloped rail and inland waterways system. However, in assessing this aid the Commission must establish both that it is necessary and that it represents genuine development aid rather than an operating subsidy to German shipyards. The necessity of the aid is an essential condition for such assessment as has been stated by the Court of Justice in Case 730/79 Philip Morris (1). Officially, Cosco currently has a fleet of 630 owned/long-term chartered vessels. Experts estimate that through its subsidiaries and other interests Cosco has control over an even higher number of ships. The vast majority of these vessels are operating in the time charter and spot charter markets all over the world. Around 80 of the above vessels are container ships, the fastest growing part of Cosco's fleet in recent years, making it the fifth largest container operator in the world.

(1) ECR 2671 [1980].

The average age of the Cosco fleet is now 14 years and this accounts for its aim of engaging in long-term fleet renewal programmes. According to information available to the Commission the new container tonnage will be deployed on the Pacific and on the company's services to the Mediterranean and North West Europe. At the moment Cosco operates six 1 100/1 300 teu vessels on its Mediterranean service and a similar number on its North West Europe service. One of the company's major aims seems to be to set up an integrated network in Europe. Cosco has for the past two to three years been self-financing and any fleet renewal programmes must be self-generated.

This all leads to the conclusion that Cosco is not a company which needs development aid in order to contribute to China's development. The company is financially capable of buying new ships on the normal market and since it operates on international shipping routes with time charter and spot contracts, its operations are not directly linked to China's import or export trade. In view of this situation the granting of unjustified aid to Cosco carries the risk of creating a serious distortion of competition to an extent contrary to the common interest. Cosco is, because of its size and independence from the freight conferences, an important player in the world shipping market and is regarded by competitors as potentially a high destabilizing force in the Pacific/Far East and Far East/Europe trades.

3. This conclusion is reinforced by the fact that Cosco is willing and able to buy the smaller 2 700 teu container vessel without development aid at normal market prices. The German Government's information shows that the smaller vessel, to be delivered to a foreign subsidiary of Cosco, Rubymonte Maritime Inc. (Panama) and to be built by HDW, will not be supported with development aid. This makes it possible for the Commission to approve the contract for this ship and close the procedure in this respect.

On these grounds the Commission considers that the aid for the construction of three container vessels for Cosco cannot be considered as genuine development aid within the meaning of Article 4 (7) of Directive 90/684/EEC and that the aid distorts or threatens to distort competition in the common market and affects trade between Member States both in the shipbuilding and in the shipping sectors to an extent contrary to the common interest within the meaning of Article 92 (1),

HAS ADOPTED THIS DECISION :

Article 1

The Commission has established that no development aid is involved in the Cosco contract for the construction of a 2 700 teu container ship by Howaldtswerke-Deutsche Werft AG, Kiel, and that the export credit terms applied are compatible with the common market.

Article 2

The proposed aid for the contract to build three further container vessels for the State-owned Chinese shipping company Cosco, at the Bremer Vulkan yard, Bremen, and the Mathias Thesen yard, Wismar, cannot be regarded as genuine development aid within the meaning of Article 4 (7) of Council Directive 90/684/EEC on aid to shipbuilding and is therefore incompatible with the common market.

Article 3

The German 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 Federal Republic of Germany.

Done at Brussels, 31 July 1992.

For the Commission

Leon BRITTAN

Vice-President